Supreme Court, U.S.
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No.

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1995

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AFRICAN ENTERPRISE, INC.,
BETHANY EVANGELICAL FREE CHURCH,
HEART CRY INTERNATIONAL,
HINDUSTAN BIBLE INSTITUTE,
INTERNATIONAL STUDENTS, INC.,
PROCLAMATION INTERNATIONAL, AND
WORLD VISION, INC.,
*Petitioners,*

v.

STEVEN S. SCHOLES,
as Receiver for Michael S. Douglas,
D&S Trading Group, Ltd., Analytic Trading Systems, Inc. and
Analytic Trading Services, Inc.
*Respondent.*

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**Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit**

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## PETITION FOR A WRIT OF CERTIORARI

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108 pp

## QUESTIONS PRESENTED

1. Whether charitable donations to nonprofit, tax-exempt charitable organizations are intended to be voidable under the fraudulent conveyance laws when they were receipted and subsequently distributed for charitable and religious work in the normal course of the tax-exempt organization's charitable operations?

2. Whether the Receiver appointed by the court in an SEC proceeding and authorized to marshall the assets of an individual and the companies he formed as instruments of a securities fraud has standing to pursue fraudulent conveyance claims against the recipients of donations from that individual?

3. Whether the application of fraudulent conveyance laws to nonprofit religious organizations violates the prohibitions of the Fourteenth Amendment against depriving persons of property without due process of law by forcing these organizations to reimburse the debtor's estate for charitable donations received from the debtor in good faith, without knowledge of the debtor's insolvency, and already spent in the normal course of charitable operations, in compliance with federal law, to further their charitable and religious missions?

4. Whether the application of fraudulent conveyance laws to religious organizations violates their First Amendment right to free exercise of religion by forcing them to reimburse the debtor's estate for charitable donations received from the debtor in good faith, without knowledge of the debtor's insolvency, and already spent in the normal course of charitable operations, in compliance with federal law, to further their charitable and religious missions?

## LIST OF PARTIES

The proceeding in the United States Court of Appeals for the Seventh Circuit, whose judgment is sought to be reviewed, consisted of four consolidated proceedings: Nos. 94-2718, 94-2947, 94-2039, and 94-2136.

The following persons and entities are now before the Court and were parties to the proceedings indicated:

Petitioners: African Enterprise, Inc., Bethany Evangelical Free Church, Hindustan Bible Institute, International Students, Inc., Proclamation International, and World Vision, Inc. (No. 94-2718); Heart Cry International (No. 94-2947).[1]

Respondent: Steven S. Scholes, as Receiver for Michael S. Douglas, D&S Trading Group, Ltd., Analytic Trading Systems, Inc., and Analytic Trading Service, Inc. (Nos. 94-2718, 94-2947, 94-2039, and 94-2136).

The following persons were parties to the proceedings indicated:

Charles Lehmann and Lisa Lehmann (No. 94-2039); Joseph E. Phillips (No. 94-2136).

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[1]Petitioners African Enterprise, Inc., Bethany Evangelical Free Church, Heart Cry International, Hindustan Bible Institute, International Students, Inc., Proclamation International, and World Vision, Inc. have no parent or subsidiary companies to be listed, pursuant to Rule 29.1 of the Rules of the Supreme Court.

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## PETITION FOR A WRIT OF CERTIORARI

Petitioners African Enterprise, Inc., Bethany Evangelical Free Church, Heart Cry International, Hindustan Bible Institute, International Students, Inc., Proclamation International, and World Vision, Inc. respectfully petition for a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit.

## OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-22a) is reported at 56 F.3d 750. The opinions of the district court (App., *infra*, 24a-68a) are reported at 854 F. Supp. 1315 and 838 F. Supp. 349.

## JURISDICTION

The decision of the United States Court of Appeals for the Seventh Circuit was entered on May 18, 1995. Petitioners African Enterprise, Inc., Bethany Evangelical Free Church, Hindustan Bible Institute, Proclamation International, and World Vision, Inc., filed a Petition for Rehearing on June 1, 1995, which was adopted by Petitioners Heart Cry International and International Students, Inc. The Court of Appeals for the Seventh Circuit denied the Petitioners' Petition for Rehearing on July 12, 1995 (App., *infra*, 23a). This Court has jurisdiction to review the judgment in question by writ of certiorari under 28 U.S.C. § 1254(1).

## CONSTITUTIONAL AND STATUTORY PROVISIONS

**U.S. Const. amend. I**

Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof . . . .

**U.S. Const. amend. XIV, § 1**

. . . nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

**Ill. Rev. Stat. ch. 59, ¶ 4 (1989) (repealed by P.A. 86-814, § 13 effective Jan. 1, 1990)**

Every gift, grant, conveyance, assignment or transfer of, or charge upon any estate, real or personal, or right or thing in action, or any rent or profit thereof, made with the intent to disturb, delay, hinder or defraud creditors or other persons, and every bond or other evidence of debt given, suit commenced, or judgment entered, with like intent, shall be void as against such creditors, purchasers and other persons.

## STATEMENT OF THE CASE

Between 1987 and 1989, the Petitioners (each being a nonprofit, tax-exempt charitable and religious organization) received a cumulative total of almost a half million dollars in charitable donations from Michael S. Douglas, the principal in several commodities trading companies. Many of these donations were designated for specific projects, and were duly expended for those charitable and religious works. The remainder were devoted to the general charitable and religious purposes of each Petitioner. Apart from the fact that a few of Mr. Douglas's donations were larger than average, there was nothing unusual about these charitable donations, nor the manner in which they were used. The entire process reflected the normal course of operations for these Petitioners,[2] who

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[2]There was nothing normal, however, about the actions of those who invested with Douglas. They responded to promises of enormous investment returns, which some have admitted sounded "too good to be true." Some early investors in fact received huge returns, were encouraged to reinvest---as is typical in Ponzi schemes---and did so. Michael Douglas had previously been convicted of

had no reason to suspect that by accepting Douglas's charitable donations they were inviting a crippling lawsuit several years hence.

Nevertheless, the Seventh Circuit has affirmed a judgment by the United States District Court for the Northern District of Illinois requiring the Petitioners to pay to Mr. Douglas's receiver the full amount of his donations---money which the Petitioners no longer have. The Petitioners are before this Court requesting its review to reverse this damaging and unjust decision. Briefly, the course of events that brought Petitioners to the steps of the Supreme Court are as follows:

In August 1987, Michael S. Douglas formed D&S Trading Group, Ltd., offering incredible returns on investments purported to involve commodities trading. During the next two years, he formed several more companies devoted to offering securities of some form or other. Many of his initial investors realized substantial profits, and Douglas's reputation spread. Although the promised returns of 120 to 300 percent per annum seemed "too good to be true," many invested. *See* Complaint ¶ 8(g).

During this period, Douglas also gained a reputation for his philanthropy. His generosity was bestowed on numerous nonprofit organizations and churches. The Petitioners received an aggregate total of more than $493,000 in donations from Mr. Douglas, much of which was designated for specific projects of interest to him.

African Enterprise received $166,000. Of this amount, $25,000 was designated for use in East Africa and $40,000 for missionary support in Tanzania. As required by its fiduciary and tax exempt status, African Enterprise expended these charitable donations for the designated projects, consistent with its exempt religious purposes.

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fraud, a fact which these investors apparently overlooked in their due diligence. It is these investors who will ultimately benefit from the judgment against the charities, if the decision below is sustained.

The remaining $101,000 was devoted to other missionary work in Africa.

Bethany Evangelical Free Church received five donations totalling $26,880, each designated for a specific purpose (*e.g.*, new church pews, youth minister's salary). The church devoted Douglas's contributions to the designated uses, in fulfillment of its religious mission.

Douglas contributed $12,485 to Heart Cry International, which used these donations to further its exempt religious purposes. Hindustan Bible Institute received $74,989.25 from Douglas and devoted the entire amount to its ministry of developing Bible institutes and ministries in India and other countries.

International Students, Inc. (ISI) was given a total of $120,450 by Douglas. $17,600 of these contributions were used for the support of specific missionaries, as designated. $100,000 was donated to support a new program to fund additional missionaries and otherwise expand ISI's ministry, and was expended for those charitable purposes. The remainder was likewise devoted to ISI's religious mission.

Almost all of Douglas's $46,728.13 in contributions to Proclamation International were designated for Africa Foundation's relief and development work, and were used to build a chicken hatchery, to pay for schooling needy children, and to construct a children's dormitory.

World Vision received $57,500 from Douglas, designated for San Francisco earthquake relief ($25,000), supporting a pastors' conference in India ($25,000), and for African relief work ($7,500).

Thus, as is typical---indeed required---of nonprofit charitable organizations, the Petitioners devoted Douglas's contributions to their tax-exempt charitable and religious purposes, consistent with the donor's designation wherever indicated.

In November 1989, Michael Douglas's house of cards came tumbling down.[3] The Securities and Exchange Commission (SEC) shut down his operations and initiated securities fraud proceedings, *SEC v. Douglas*, No. 89 C 8407 (N.D. Ill.) (Alesia, J.), alleging that Mr. Douglas had been operating a Ponzi scheme. Mr. Douglas was eventually found guilty and sentenced to prison.

Meanwhile, the SEC had requested the district court to appoint a receiver to marshall the assets of Douglas and his companies. The Court appointed Steven S. Scholes, who subsequently brought this action against the Petitioners and several other charities. The first complaint was filed on July 13, 1990, in the Northern District of Illinois. Mr. Scholes alleged, as the basis for federal jurisdiction, that the action was "commenced by the Receiver pursuant to his authority under the Order Appointing a Receiver and Order of Permanent Injunction" and that the court's jurisdiction "is therefore ancillary to the subject matter jurisdiction of the Receivership Court in the SEC Action." Complaint ¶ 4.

Mr. Scholes alleged three alternative theories of recovery: fraudulent conveyance, unjust enrichment, and constructive trust. The constructive trust counts were dismissed by the district court. *See Scholes v. African Enterprise, Inc.*, 838 F. Supp. 349 (N.D. Ill. 1993). Eventually, the court granted summary judgment to Scholes on the fraudulent conveyance counts, not reaching the unjust

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[3]Petitioners' acknowledgement of Douglas's fall does not imply acceptance of the district court's findings of fact. Indeed, the district court's substantial reliance on inadmissible evidence to support its summary judgment decision was presented to the Seventh Circuit for review as reversible error. In rendering its judgment against the Petitioners, the district court improperly relied on Douglas's criminal indictment, on an unsigned transcript of a deposition of Douglas at which he was unrepresented and of which the Petitioners did not receive notice, on affidavits by the receiver and his expert witness, and on a plea agreement not of record. In contrast to this liberal treatment of the receiver's evidence, the district court struck and refused to consider an admissible affidavit of Douglas offered by the Petitioners. Petitioners also may press these evidentiary issues if this Court grants their petition.

enrichment claims. *See Scholes v. African Enterprise, Inc.*, 854 F. Supp. 1315 (N.D. Ill. 1994).

Petitioners appealed to the Seventh Circuit. The appellate court declined to consider the constitutional arguments advanced by ISI and, after addressing the Petitioners' arguments regarding fraudulent conveyance, affirmed the district court's decision. *See Scholes v. Lehmann*, 56 F.3d 750 (7th Cir. 1995).

## SUMMARY OF REASONS FOR GRANTING THE WRIT

For the first time, a federal appellate court has ruled that charitable donations to an innocent public charity, received in the normal course of charitable operations and duly distributed for charitable purposes, may be voided as fraudulent transfers. If allowed to stand, this decision will have a devastating impact not only on the Petitioners but on the entire nationwide charitable sector which is responsible for distributing more than $100 billion annually to the poor and needy.

If the Seventh Circuit's decision becomes the law of fraudulent conveyance, every charity will be subject to liability for the amount of any donations received from an impecunious debtor, even if the charity had no knowledge of the debtor's status and even though the donations have long since been expended on the charity's benevolent purposes. Armed with this precedent, federal bankruptcy trustees and other federal agents will increasingly be using the federal courts to impose damaging liability on charities, for the benefit of creditors who are "perhaps greedy and foolish investors."

This unprecedented result ignores the unique nature of charitable donations. Unlike private gifts, charitable contributions do not---cannot---inure to the benefit of the recipient charity. Instead, they are provided to the charity with the understanding that they will be used to provide necessary goods or services to the objects of the charity's mission. If the charity were a for-profit entity, this would

be considered adequate consideration; it should also be construed as adequate consideration in the charitable context.

To conclude otherwise and apply fraudulent conveyance laws to charities violates the constitutional protections of the 14th Amendment. By treating charities differently than similarly situated for-profit entities---by failing to recognize the adequacy of consideration for donations and by holding charities liable for the full amount of monies transferred when for-profits are held liable only for the net amount---application of these laws violates the guarantee of equal protection. Since the donations have long since been spent, a fraudulent conveyance judgment effects a confiscation of the property of an innocent entity, a gross violation of due process. Moreover, for these Petitioners, treating donations as fraudulent transfers substantially burdens their ability to freely receive and distribute donations according to their religious beliefs, violating their First Amendment free exercise right.

In addition to these constitutional violations, application of fraudulent conveyance laws to charitable donations unjustly shifts the risk of debtor default from lenders and investors, who are motivated and required to conduct due diligence, to charities which are neither positioned to conduct due diligence nor to otherwise bear the risk. Treating charitable donations as fraudulent transfers is inconsistent with the nature of charitable funds as invested with a public trust and contrary to the intent of the law.

## REASONS FOR GRANTING THE WRIT

### I. CONSTRUING CHARITABLE DONATIONS AS FRAUDULENT CONVEYANCES VIOLATES THE INTENT OF THE LAW AND WILL SEVERELY IMPACT THE NATIONWIDE CHARITABLE SECTOR.

### A. Charities Have No Reasonable Means to Avoid, Insure Against, or Pay for the Liability that May Be Imposed if Charitable Donations Are Construed as Fraudulent Conveyances.

If allowed to stand, the Seventh Circuit's decision in this case will have a devastating impact on all charitable organizations. There is, thankfully, little precedent for this action. Thankfully because, until recently, few plaintiffs---indeed, few attorneys---would have seriously contemplated suing an innocent charity for a money judgment for the amount of charitable donations made years before by an impecunious debtor.

But times have changed. And so, the receiver charged with marshalling the assets of Michael Douglas has done what most---including the drafters of the fraudulent conveyance laws---would never have dreamed would be done. He has sued charities who had no relationship to the debtor, apart from receiving his charitable donations in the normal course of business, for the return of monies they no longer have, to satisfy Mr. Douglas's creditors.

In many ways, this case is the first of its kind. Consequently, it is being closely watched by charities across the country. Receivers and bankruptcy trustees are less interested. The vast majority of practitioners appear to assume, with little serious thought, that charitable donations may be voided in fraudulent conveyance actions, and that charities are without defense. This lack of analysis probably stems from a lack of appreciation for the devastating harm that such an outcome can bring upon a charitable organization, as well as a lack of understanding regarding the extreme injustice of subjecting charities to the workings of a law which, when applied "equally" to them, brings about a result that is radically unequal and discriminatory.

Charities receive income in the form of contributions and spend it on their charitable purposes. They do not accumulate stockholders' equity. They do not accumulate and distribute profits. Apart from

whatever reserves are necessary to cover periodic administrative expenses and, where appropriate, to cover planned expansions of buildings and real property needed to support their operations, charities do not accumulate funds. They promptly spend them for their charitable purposes. This is what they are chartered to do. Indeed, they are invested with a public trust to do precisely this.

Thus, by their very nature charities are in no position to bear the risk that donations received in the normal course of charitable operations may be voided at some time in the future, with a resulting money judgment against the charity. Except for cases where the charity has some basis for knowing or suspecting a problem (and everyone acknowledges that is not this case), it will be hit with a fraudulent conveyance action long after it has spent the money.

Its only option, then, is to satisfy a judgment by eliminating or curtailing existing charitable programs and staff and from existing funds---which of course are already committed. Ultimately, if these drastic measures are insufficient the charity will go bankrupt. Moreover, the charity cannot insure against this risk.[4] Obviously, charities cannot investigate all donors, or even major donors, without incurring substantial costs and suffering a substantial loss of income.[5] Most large donors would undoubtedly be incensed, or at the very least deterred from giving, by the prospect of being so scrutinized. And even if charities could effectively mount and fund

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[4]Judge Posner was wrong when he said that "it appears that such insurance [against liability for fraudulent conveyance] is offered, though with limitations that may greatly reduce its value, and perhaps only for conveyances of real estate." *Scholes v. Lehmann*, 56 F.3d at 761. The authority he cites actually says that title insurance policies have been revised to add exceptions applicable to bankruptcies filed during the one-year period following the sale, effectively excluding fraudulent conveyance claims from coverage. Lawrence D. Coppel & Lewis A. Kann, *Defanging Durrett: The Established Law of "Transfer,"* 100 Banking L.J. 676, 677 (1983). Thus, even for real estate, fraudulent conveyance insurance is unrealistic.

[5]The Seventh Circuit agrees that this option "hardly seems feasible." *Scholes v. Lehmann*, 56 F.3d at 761.

such investigations, there is no guarantee that they would uncover a donor's potential insolvency and thereby avoid future fraudulent conveyance actions, especially where, as in this case, the donor's debts arose from well-hidden criminal activity.

Contrary to the Seventh Circuit's suggestion, *see Scholes v. Lehmann*, 56 F.3d at 761, it would not be "feasible but costly" for charities to hold cash reserves. Most charities are challenged meeting payroll, let alone accumulating reserves for an inchoate future contingency. Most charities have no guaranteed income stream. They depend on donor contributions---donors who expect their money to be devoted to charitable purposes, not to a fund to reimburse defrauded investors. Typically, any unusual financial need requires a charity to make a special fundraising appeal. How realistic is it to assume that a charity would succeed in a fundraising drive for its "Fraudulent Conveyance Fund"? No, holding cash reserves is hardly feasible for most charities.

This case may be among the first of its kind, but it will not be the last. Indeed, hundreds of millions of dollars of charitable contributions are hanging in the balance in a Philadelphia bankruptcy court as a result of the collapse of the Foundation for New Era Philanthropy (FNEP). *See* Steve Stecklow, *Owing $500 Million, New Era Charity Seeks Refuge From Creditors*, Wall St. J., May 16, 1995, at A1. Fraudulent conveyance actions probably would have been filed already against the numerous charities that received donations from FNEP, but for the facts that most of the creditors who "invested" are themselves charities and that there are some large potential third-party defendants that might be held liable for much of the loss. However, if the Trustee and the creditors are unable to agree on a reasonable settlement, we will see fraudulent conveyance actions that are orders of magnitude greater than this case.

The seal has been broken. It would be foolhardy to assume that the future will not bring many more such cases, if the Seventh Circuit's opinion is allowed to stand. The specter of this kind of liability will have a substantial adverse effect on all charities, and ultimately on

the entire public sector. Some charities providing public benefit will function in a substantially diminished capacity because they will be extremely wary of receiving any large donations. Some, if held liable for the repayment of substantial donations, will be forced to liquidate.

This Court has the opportunity to inject some desperately needed sanity into the application of fraudulent conveyance laws by various instruments of the federal government[6] before further harm is done to the charitable community. There is little to be gained by waiting for a split to develop in the Circuits.[7] Two district court cases have reached a conflicting opinion. *See Matter of Moses*, 59 B.R. 815 (Bankr. N.D. Ga. 1986); *In re Missionary Baptist Foundation of America, Inc.*, 24 B.R. 973 (Bankr. N.D. Tex. 1982); *cf. In re Chomakos*, 170 B.R. 585, 595-96 (Bankr. E.D. Mich. 1993) (holding gambling losses not voidable under fraudulent conveyance laws). Moreover, the Justice Department's decision to withdraw its support of a bankruptcy trustee seeking to void donations to a church implies that the Executive Branch may have taken a position in conflict with the Seventh Circuit's opinion. *See* Pierre Thomas, *Clinton Stops Justice Department From Seeking Forfeiture of Tithes*, Wash. Post,

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[6]It appears that the only reported instances where plaintiffs have attempted to void charitable donations using fraudulent conveyance laws have been in federal courts and, with one exception, instigated by federal agents or agencies. *See Scholes v. Lehmann*, 56 F.3d 750 (7th Cir. 1995), *aff'g Scholes v. African Enterprise*, 854 F. Supp. 1315 (N.D. Ill. 1994) (SEC receiver); *Zahra Spiritual Trust v. United States*, 910 F.2d 240 (5th Cir. 1990) (IRS); *In re Newman*, 183 B.R. 239 (Bankr. D. Kan. 1995) (bankruptcy trustee); *In re 375 Park Ave. Associates, Inc.*, 182 B.R. 690 (Bankr. S.D.N.Y. 1995) (bankruptcy trustee); *Christians v. Crystal Evangelical Free Church (In re Young)*, 152 B.R. 939 (D. Minn. 1993), *aff'g In re Young*, 148 B.R. 886 (Bankr. D. Minn. 1992) (bankruptcy trustee); *Tcherepnin v. Franz*, 457 F. Supp. 832 (N.D. Ill. 1978) (receiver); *Matter of Moses*, 59 B.R. 815 (Bankr. N.D. Ga. 1986) (bankruptcy trustee); *In re Missionary Baptist Foundation of America, Inc.*, 24 B.R. 973 (Bankr. N.D. Tex. 1982) (bankruptcy trustee).

[7]Only two appellate decisions have been reported interpreting the applicability of fraudulent conveyance laws to charitable donations, *see* n.6, *supra*, and only the decision in this case involved donations to public charities.

Sept. 16, 1994, at A8 (in appeal of *Christians v. Crystal Evangelical Free Church*, n.6, *supra*, pending before 8th Cir.). Unless this Court provides an authoritative interpretation of the inapplicability of fraudulent conveyance laws to charitable donations,[8] irreparable damage will probably be done to many religious and charitable organizations before the tide can be turned, either by lower courts or by legislatures. In this time when government is downsizing and the public must increasingly look to public charities to provide essential services for the least fortunate among us, charities must be protected from creditors seeking to recoup their failed investments from any pockets in reach.

### B. Charitable Donations, on Which the Law Imposes a Public Trust, Were Never Intended to Be Voidable as Fraudulent Conveyances.

This case was triggered by the conduct of Michael Douglas, who became a "debtor" by perpetrating a massive securities fraud and devoted a substantial portion of his gains to charitable causes. However, Douglas's wrongdoing is irrelevant to the legal issues involved in this case.[9] If Michael Douglas and his corporate entities had been imprudent but not immoral, the Petitioners would be in precisely the same position they are now, although the plaintiff would be a bankruptcy trustee rather than a receiver. The fraudulent conveyance laws do not depend on---or even consider---wrongdoing

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[8]The receiver proceeded under the Illinois Fraudulent Conveyance Act (hereinafter the "Act"), Ill. Rev. Stat. ch. 59, ¶ 4, (repealed by P.A. 86-814, § 13 effective Jan. 1, 1990, adopting the Uniform Fraudulent Transfer Act). The Seventh Circuit concluded that what the new act---and the corresponding provision of the federal Bankruptcy Code---state expressly is the same as implied in the old Act. Thus, this opinion has direct bearing on the interpretation of all fraudulent transfer laws, both state and federal.

[9]The Seventh Circuit implies otherwise in its hypothetical discussion of whether a donation dropped into the church collection plate by one who obtained the money through fraud or larceny could be avoided as a fraudulent transfer may contribute to this erroneous impression. *See Scholes v. Lehmann*, 56 F.3d at 759-60.

by either the transferor or the transferee, other than the intent that motivated the alleged fraudulent transfer. This case is not about thievery or fraud. It is about whether the fraudulent conveyance laws were intended to protect creditors at the expense of innocent charities, placing them in a worse position than they were before receiving the voided transfers.

Because the charities no longer have the money belonging to the debtor, against which the creditors assert a claim, they are effectively being asked to guarantee the creditors' interests in the debtor's estate by depleting their own charitable assets. A careful construction of the law reveals that position is unsupportable.

1. Charitable Donations, Unlike Private Gifts, Exhibit Characteristics that Should Be Construed as Adequate Consideration Under the Fraudulent Conveyance Laws.

Consideration is "some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other." *Lipkin v. Koren*, 392 Ill. 400, 406, 64 N.E.2d 890, 893 (1946); *Palmetto Leasing Co. v. Chiles*, 235 Ill. App. 3d 986, 989, 602 N.E.2d 77, 79 (2d Dist. 1992). By definition, gifts are transfers made without consideration. *Black's Law Dictionary* 619 (5th ed. 1979). Charitable donations, however, involve both an economic benefit accruing to the donor and a legal responsibility undertaken by the donee charity, and therefore are not "gifts" in the classical, common law sense of that term.

With every charitable contribution, the donor receives the right to deduct the amount of the donation from taxable income. 26 U.S.C. § 170(a)(1). This is a substantial economic benefit for a high income taxpayer such as Douglas, and therefore represents valuable consideration for the charitable donation.

As further substantial consideration for each contribution, the charity undertakes a significant legal obligation. Donors give to

charity not with the intent to benefit the charity, as an entity, but with the expectation that their donations will be used by the charity in a certain way, for the benefit of others. Charitable donations are conditioned on that understanding. In fact, many donations, including many of Douglas's contributions to the Petitioners, are expressly designated by the donor to be used for a specific purpose. With these designated donations, the charities are obligated to not only use the gifts for charitable purposes, but for the specific restricted charitable activity for which the donation was given.

In the most fundamental ways, charitable donations are unlike private gifts. Any construction of laws allegedly applicable to gifts is incomplete if it fails to consider these distinctions[10]. Whereas private gifts inure to the benefit of the grantee, charitable donations do not---indeed, cannot. The distinctive mark of an exempt charitable organization is that its assets cannot inure to a private benefit and must be used to further charitable purposes. The beneficiaries of charitable donations are not the charities, but the third parties that receive benefits from the charities.

Thus, every time a charity accepts a charitable donation, it undertakes the responsibility to use that donation to benefit the objects of its charitable mission. With designated or restricted donations, the charity has an even greater responsibility to utilize the monies for the specific designated charitable purpose. This is adequate consideration by any reasonable definition.

Consider the following example. David Debtor, having recently become insolvent, goes into a restaurant and orders a meal for $10. Obviously, Debtor's estate has been depleted by $10, yet no one would argue that this was not adequate consideration since Debtor

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[10]The Seventh Circuit dismissed the Petitioners' arguments that the unique nature of charitable donations gives rise to adequate consideration with the unsupported assertion that "a gift to charity (to anyone, for that matter) is not in exchange for full in the sense of commensurate consideration. Otherwise it would not be a gift, but an exchange." *Scholes v. Lehmann*, 56 F.3d at 759.

received, in return for his $10, a meal presumably valued at $10. Thus, the Seventh Circuit is wrong when it reasons that the adequacy of consideration is determined by the impact on the debtor's estate. *See Scholes v. Lehmann*, 56 F.3d at 756-57. Many legitimate commercial transactions may leave the debtor in a weakened financial position, with fewer assets available to satisfy creditor demands. The debtor may purchase food, which he consumes; the debtor may purchase toilet paper and other sundries, which he uses and discards; the debtor may purchase personal services, such as a haircut; the debtor may purchase transportation services, which add nothing to his estate; the debtor may purchase entertainment, such as a concert ticket. It would be absurd to suggest that these transactions, clearly involving consideration, are subject to voiding as fraudulent conveyances. Yet every one of these transactions, and many more like them, effectively reduce the debtor's estate and thereby "hinder" creditors. Clearly, the impact on a debtor's estate is not the determining factor as to whether there has been consideration, for purposes of determining whether a fraudulent conveyance has occurred.

Indeed, a debtor's gambling losses have been held to be transfers for "reasonably equivalent value" and thus not subject to avoidance under fraudulent conveyance law. After considering the facts and circumstances surrounding a bankrupt couple's gambling losses, which the Trustee was seeking to void, the Eastern District of Michigan Bankruptcy Court concluded that to hold the casino liable under the fraudulent conveyance laws would be

> to conclude that each casino and lottery operator . . . is in reality a protector of the creditors of its customers, to the point that to protect themselves they must continuously inquire and be sufficiently knowledgeable as to the financial circumstances of each of its patrons so that they can, in light of the knowledge thus obtained, refuse access to certain of those patrons. As a general proposition, that would tip the scales inordinately in favor of creditors and do excessive harm to society's interest in maintaining the integrity of legal and commercial transactions

> and thereby do violence to the real interest and concepts underlying [the applicable fraudulent conveyance acts].

*In re Chomakos*, 170 B.R. 585, 595-96 (Bankr., E.D. Mich. 1993). In the same way, the Seventh Circuit's conclusion that each charity is a protector of its donors' creditors tips the scales inordinately in favor of creditors and does excessive harm to society's interest in maintaining the integrity of legal transactions (charitable donations), thereby doing violence to the real intent and concepts underlying the fraudulent conveyance laws.

To continue with our hypothetical example: While Debtor is eating, he sees an obviously homeless mother and child staring in the window. Out of compassion, Debtor orders two more meals and tells the waitress to give them to the emaciated child and her mother. Here again, it would be unreasonable to argue that there was not adequate consideration, even though Debtor received nothing of value, because the restaurant provided two meals to two third parties as consideration for Debtor's $20. The Petitioners' situation is clearly analogous to that of the restaurant. They received money from Douglas, not for their own benefit but for the purpose of conferring benefits on poor and needy third parties. This is adequate consideration and the benefit goes to the "least of these" in our society -- a worthy proposition that American law should support not undermine.

In addition to ignoring the badges of consideration inherent in charitable donations, the Seventh Circuit's holding produces a dramatic logical inconsistency. The mere promise of a charitable donation invests the promisee with a legal right to enforce the promise (see discussion, *infra* pp. 18-19). If Douglas had promised to make the donations that the receiver is seeking to void but had failed to deliver as promised, the Petitioners would have been entitled to enforce those promises. Indeed, the Petitioners would have become creditors of Douglas's estate, with the same standing as the investors! It strains credulity to conclude that the Petitioners have no entitlement to Douglas's donations because they actually

received them, when they would have been entitled to the donations if they had been promised but not delivered. The donations from Douglas to the Petitioners involved legally cognizable consideration.

2. Treating Charitable Donations the Same as Private Gifts Is Inconsistent with the Unique Legal Status of Charities.

> Few aspects of American society are more characteristically American than the nation's array of voluntary organizations . . . [which] has long been widely recognized as part of the very fabric of American life . . . reflect[ing] a national belief in the philosophy of pluralism and in the profound importance to society of individual initiative.

Bruce R. Hopkins, *The Law of Tax-Exempt Organizations* § 1.3, at 11-12 (6th ed. 1992) (quoting from *Giving in America---Toward A Stronger Voluntary Sector* (1975), the report of the Commission on Private Philanthropy and Public Needs). Almost a half million of these voluntary organizations are charities. Bruce R. Hopkins, *Charity, Advocacy, and the Law* § 1.4, at 15 (1992). In 1992, more than $124.31 billion was given to charity in the United States, *id.* at 2 (Supp. 1994), including Petitioners and others that minister to the many needs in our society.

It is "not only a policy of the people, but likewise a legislative policy, to deal broadly and sympathetically with charity." 15 Am. Jur. 2d *Charities* § 12 (1976). This solicitude is grounded in the recognition that charitable organizations are not merely another form of private enterprise, but instead provide uniquely public benefits. *See, e.g., Trinidad v. Sagrada Orden de Predicadores*, 263 U.S. 578, 581 (1924) (tax exemption recognizes public benefit from charities' activities).

Reflecting this well established distinction between charities and other entities, the law does not consider the property of charitable

organizations to be private property in the same sense as property of individuals and other private organizations. As long as it is used to advance an organization's charitable purposes, property of a charity is considered "consecrated to the public use, and becomes part of the public resources for promoting the happiness and well-being of the people." 15 Am. Jur. 2d *Charities* § 151 (1976).

Consistent with this principle, the "organizational test" for exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code ("IRC"), 26 U.S.C. § 501(c)(3), requires a charity's assets to be "dedicated to an exempt [charitable] purpose." 26 C.F.R. § 1.501(c)(3)-1(b)(4). This is a permanent dedication, and the Internal Revenue Service normally requires organizations applying for recognition of exempt status to include an express provision in their articles of incorporation stating that when the organization dissolves, its assets will be distributed only for exempt purposes. *See id.* In like manner, to pass the "operational test" for maintaining its exemption under IRC § 501(c)(3), a charity must ensure that no part of its net earnings inures to the benefit of private shareholders or individuals. 26 C.F.R. § 1.501(c)(3)-1(c)(2).

Thus, when a donor gives property to a charitable organization, that property becomes transformed into something quite different than when it was in the donor's hands and quite different than if it had been transferred to an individual or other private entity. The donated property is no longer private, but held in public trust, for purposes of public benefit, forever.

Consequently, the law treats donations to charitable organizations in a substantially different manner than other types of gifts. Charitable contributions are viewed with "peculiar favor by the courts, which take special care to enforce them." *Raser v. Johnson*, 9 Ill. App. 2d 375, 379, 132 N.E.2d 819, 821 (2d Dist. 1956). Charitable gifts are "frequently sustained under circumstances in which private gifts or trusts would fail." 15 Am. Jur. 2d *Charities* § 1. Indeed, the "great bulk of the jurisdictions . . . hold that a charitable pledge constitutes an enforceable contract." *Jewish*

*Federation v. Barondess*, 560 A.2d 1353, 1353 (N.J. Super. Ct. 1989).

Historically, courts have enforced charitable subscriptions by finding consideration or by applying the doctrine of promissory estoppel. *See Salsbury v. Northwestern Bell Tel. Co.*, 221 N.W.2d 609 (Ia. 1974). However, the "real basis for enforcing a charitable subscription is one of public policy---that enforcement of a charitable subscription is a desirable social goal." *Barondess*, 560 A.2d at 1354. Most courts have recognized that "to withhold judicial sanction from such obligations would be to destroy millions of assets of the most beneficent institutions in our land, and to render such institutions helpless to carry out [their charitable] purposes." *Id.* (quoting *More Game Birds In America, Inc. v. Boettger*, 125 N.J.L. 97, 100-101, 14 A.2d 778 (E. & A. 1942)).

Given the public trust quality of charitable donations, and the special favor accorded them under the law, there is every reason to presume that the Legislature did not intend for them to be voidable pursuant to the Act. Strongly reinforcing this presumption is the fact that application of fraudulent conveyance law to charitable donations produces unjust consequences.

To qualify for continuing exemption from taxation, charities must be "operated exclusively" for the purposes that qualify them as exempt charities. IRC § 501(c)(3). Therefore, they must promptly apply all contributions to their charitable purposes and may not retain donations in an amount greater than what is reasonably required to support continuing operations and any planned expansion of their mission.

Consistent with this principle, the Petitioners have long since devoted Douglas's contributions to fulfilling their respective charitable missions. The monies received from Douglas were not retained by the Petitioners and are not available to satisfy the receiver's claims--unless, of course, the receiver desires to pursue the third party beneficiaries of these donations, such as the famine

victims fed by World Vision or the African children who received housing and schooling through the ministry of Proclamation International. Merely to contemplate this logical extension of the receiver's application of the Act illustrates the absurdity and injustice of construing it to allow voiding of charitable gifts.

The issue is not simply that the specific chattel donated by Douglas are no longer in the Petitioners' possession, but that the Petitioner realized no net increase in assets from which a judgment might be satisfied. Therefore, a money judgment against the Petitioners is unjust because it places them in a substantially worse position than if they had never received the donations from Douglas.

It is also manifestly unjust to force the Petitioners to divert their precious resources from their missions to the poor, the hungry, and the spiritually thirsty, merely to compensate investors who were duped by Michael Douglas. This shifting of the investors' risk to the Petitioners is unfair, imprudent from a policy standpoint, and contrary to Illinois law. *See In re Liquidation of Sec. Casualty Co.*, 127 Ill. 2d 434, 446, 537 N.E.2d 775, 781 (1989) (investors are "deemed to assume the additional risk of the illegal or fraudulent issuance of securities").

The investors knew, or should have known, that there was a risk that they might lose some or all of their investment. If nothing else, the representations that investors could expect returns of 10 to 25 percent per month, Complaint ¶ 8(g), should have caused them to raise questions and approach these investments with care. Moreover, with due diligence, the investors would have discovered that Michael Douglas previously had been convicted and imprisoned for fraud.[11]

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[11]*See* Statement of Material Facts as to Which There Is No Genuine Issue With Respect to Hindustan Bible Institute, Inc., International Students, Inc. and Proclamation International, Inc. ¶ 7.

The Petitioners, in contrast, had no reason to know that they were at risk by accepting charitable donations from Douglas. Yet the judgment against them effectively requires the Petitioners to bear the risk that any donation could be subject to being voided for five years or more after receipt,[12] if the donor later turns out to be an insolvent debtor.

There is no basis in logic or fundamental fairness for imposing on charities the requirement to bear this risk. In fact, it immunizes the "very foolish, very naive, very greedy, or very Machiavellian investor," *see Scholes v. Lehmann*, 56 F.3d at 760, from his failure to conduct adequate due diligence, effectively shifting to the innocent charity the enormous risk the investor took by "jump[ing] at a chance to obtain a return on his passive investment of 10 to 20 percent a month," *id.* There is simply no way that charities can effectively bear this risk (see discussion, *supra* pp. 7-10), nor should the law impose on charities the obligation to guarantee the risks undertaken by such investors or to undertake a "due diligence" investigation of donors to protect investors who have failed to adequately conduct their own due diligence. To do so would be radically inconsistent with the unique status and treatment that the law has always accorded to charities and charitable donations.

3. The Fraudulent Conveyance Laws Should Be Construed to Avoid Unjust and Unintended Consequences.

The "sole object of [statutory] construction is to determine the legislative intent." *Adler v. Northern Hotel Co.*, 175 F.2d 619, 620 (7th Cir. 1949). "No matter how clear the [statutory] text seems, it must be interpreted . . . like any other communication." Richard A. Posner, *Legal Realism, and the Interpretation of Statutes and the Constitution*, 37 Case W. Res. L. Rev. 179, 187 (1986-87). The court's role is to ascertain and give effect to the legislature's intent.

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[12] *See* Ill. Rev. Stat. ch. 110, ¶ 13-205 (general statute of limitations).

*People v. Zaremba*, 158 Ill. 2d 36, 40, 630 N.E.2d 797, 799 (1994); *accord Buttitta v. City of Chicago*, 9 F.3d 1198, 1203 (7th Cir. 1993).

Although the language of the statute is the starting point for this task, *see Zaremba*, 158 Ill. 2d at 40, 630 N.E.2d at 799, the court's interpretation even of unambiguous statutory language is subject to certain fundamental presumptions. For example, a court will presume that the legislature did not intend unjust consequences. *People ex rel. Cason v. Ring*, 41 Ill. 2d 305, 315, 242 N.E.2d 267, 273 (1968). If there are two possible constructions, one of which renders an absurd result and the other "reasonable and wholesome," the court must elect the latter, *Carter Oil Co. v. Norman*, 131 F.2d 451, 457 (7th Cir. 1942), because a court will not construe a statute in a manner that would lead to absurd or unjust consequences, *Loyola Academy v. S&S Roof Maintenance, Inc.*, 146 Ill. 2d 263, 273, 586 N.E.2d 1211, 1216 (1992). The judgment against the Petitioners is based on just such a construction, leading to unjust consequences for the Petitioners and their beneficiaries.

"It is a 'familiar rule, that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit nor within the intention of its makers.'" *Nat'l Woodwork Mfrs. Ass'n v. Nat'l Labor Relations Bd.*, 386 U.S. 612, 619 (1967) (quoting *Holy Trinity Church v. United States*, 143 U.S. 457, 459). In such a case, the court has a "duty . . . to restrain [the statute's] operation within narrower limits than its words import, if the court are satisfied that the literal meaning of its language would extend to cases which the legislature never designed to embrace in it." *McKee v. United States*, 164 U.S. 287, 293 (1896) (quoting *Brewer v. Blougher*, 14 Pet. 178, at 198); *United States v. About 151.682 Acres of Land*, 99 F.2d 716, 721 (7th Cir. 1938).

Fraudulent conveyance statutes, "in ultimate effect, deal with the property itself or its equivalent in the hands of the debtor's grantee, or the transferees of the latter . . . [and] a return of the property intact by any of these transferees . . . would discharge the transferee from further responsibility." Garrard Glenn, *The Law of Fraudulent*

*Conveyances* § 57 (1931). Thus, a fundamental presumption of fraudulent conveyance laws is that the grantee has either retained the property or has received equivalent value in return for its subsequent transfer.

Not so in this case. The Petitioners received no legally cognizable value when they used Douglas's donations to feed the hungry, house the homeless, and educate needy children. This is not the factual scenario contemplated by the fraudulent conveyance laws.

Moreover, it is clearly the intent of fraudulent conveyance laws to leave the grantee in the same, but no worse, position than it was in prior to the transfer. Fraudulent conveyance statutes, such as the Illinois Act, void the fraudulent transfer, returning to the debtor's estate the transferred property and leaving the transferee in the same position as before the transfer. These laws are designed to put things back to the same state they were in prior to the transfer.

Where the grantee no longer possesses the property, a money judgment arguably may be obtained against him. However, this remedy is consistent with the fundamental design of the fraudulent conveyance laws only if the grantee obtained equivalent value when he relinquished possession of the property. Otherwise, it is unreasonable to penalize the grantee by imposing a money judgment because it places the grantee in a worse position than before. Instead, the creditor's remedy should lie against the ultimate recipient of the debtor's property rather than the first grantee, since fraudulent conveyance statutes "deal with the property itself or its equivalent in the hands of the debtor's grantee, or the transferees of the latter." Glenn, *The Law of Fraudulent Conveyances* § 57 (emphasis added).[13]

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[13]The Uniform Fraudulent Transfer Act provides further evidence that fraudulent conveyance laws are designed to leave the grantee in the same, but no worse, position than prior to the transfer. When a transferee has received a fraudulent transfer for which the transferee has given value, but not "reasonably equivalent value," the transferee may be liable for return of the property or its

Drafters and interpreters of fraudulent conveyance laws have never contemplated that an innocent recipient of fraudulently conveyed property would be held legally liable for its value if the innocent recipient neither retained the property nor received equivalent value when he passed the property along to another.[14] These laws were designed to reduce the risk to creditors that debtors will deplete their estates, not to shift that risk from investors or creditors to innocent recipients of charitable transfers. Yet what the Seventh Circuit's decision effectively does is shift the risk of fraudulent transfers from the investors/creditors to the Petitioners, transforming these charities into guarantors of the investors' risk. The fraudulent conveyance laws were never intended to do this. They should be construed to exclude charitable donations to innocent charities, to avoid this unintended and unjust result.

## II. THE SEVENTH CIRCUIT'S OPINION AFFIRMING THE RECEIVER'S STANDING TO BRING THIS ACTION WAS WRONGLY GROUNDED IN THE HARM SUSTAINED BY CREDITORS, RATHER THAN THE ENTITIES REPRESENTED BY THE RECEIVER.

The Seventh Circuit correctly acknowledged that "an equity receiver may sue only to redress injuries to the entity in receivership." *Scholes v. Lehmann*, 56 F.3d at 753 (citing *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972)). Paraphrasing the question posed by the Petitioners and other defendants, the court then asked, "How . . . could the allegedly fraudulent conveyances have hurt Douglas, who engineered them, or

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equivalent value, but is entitled to an offset equal to the amount of value that the transferee gave the debtor for the property. *See, e.g.*, Ill. Rev. Stat. ch. 59, ¶ 109(d).

[14]A few bankruptcy courts have held third party beneficiary contract payments to be fraudulent transfers, *see, e.g., In re Globe Tanker Services, Inc.*, 151 B.R. 23, 25 (Bankr. D. Conn. 1993), but these opinions did not consider the impact on the grantee, nor the intent of the legislature with respect to third-party beneficiary contracts.

the corporations that he had created, that he totally controlled and probably . . . owned all the common stock of, and that were merely the instruments through which he operated the Ponzi scheme?" *Id.* at 754. As the Seventh Circuit said, Douglas, as sole shareholder, "could lawfully have ratified the diversion of corporate assets to noncorporate purposes--but only if creditors were not harmed." *Id.* But creditors were harmed. Thus, the receivership entities were injured.

So, we have this syllogism: (1) an equity receiver may sue only to redress injuries to the entity in receivership; (2) Douglas's diversions harmed the entities only because creditors were harmed; (3) therefore, the receiver may sue because creditors were harmed! Even so, Douglas's corporations would not have standing to assert a claim on the assets diverted "because of their deep, their utter, complicity in Douglas's fraud." *Id.* What changed this? "The appointment of the receiver removed the wrongdoer from the scene." *Id.*

This twisted logic stands the rule of *Caplin*, proclaimed by this Court more than 20 years ago, on its head. *Caplin* says that an equity receiver may sue only to redress injuries to the receivership entity. Following the Seventh Circuit's logic, the entity is injured any time creditors are injured, and the mere appointment of the receiver removes any barrier to the entity bringing suit. This reasoning effectively grants an equity receiver unlimited standing to bring any and all actions that could arguably increase the estate's assets, transforming *Caplin* into a nullity. Petitioners respectfully request this Court to grant their petition for a writ of certiorari, to correct the Seventh Circuit's serious misinterpretation of this Court's precedent in *Caplin*.

## III. APPLICATION OF THE FRAUDULENT CONVEYANCE ACT TO CHARITABLE DONATIONS VIOLATES THE FIRST AND FOURTEENTH AMENDMENTS.

The Court has consistently followed a policy of construing statutes to avoid constitutional violations "if any other possible constructions remains available." *NLRB v. Catholic Bishop of Chicago*, 440 U.S. 490, 500 (1979). In *Catholic Bishop*, this Court construed the broad jurisdictional provision of the National Labor Relations Act as implicitly excluding church-operated schools, to avoid constitutional difficulties. Because of the substantial constitutional difficulties created by applying the fraudulent conveyance laws to religious charities and churches, this Court should construe those laws in the same manner.

Before the Seventh Circuit, Petitioner ISI raised several constitutional issues, including violations of free exercise, freedom of association, due process, and equal protection. All of the Petitioners raised a due process argument in the district court.[15] In this Petition, we address the most compelling constitutional arguments to emphasize that the only reasonable interpretation of legislative intent is to construe the Act as not reaching charitable donations. Nevertheless, if the Court determines that the Act must be interpreted to encompass charitable donations, the Petitioners respectfully request it to consider the constitutionality of such a statute.[16]

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[15]*See* Memorandum of Certain Defendants in Support of Motion to Dismiss, at 31-33 (Nov. 30, 1990).

[16]The Seventh Circuit did not consider any constitutional arguments. Although ISI raised several in its brief to the Seventh Circuit, the Court mentioned only the free exercise claim. It refused to consider this argument because the state Attorney General had not been given an opportunity to defend the statute. The Petitioners submit that the constitutional issues in this case are sufficiently compelling, and capable of being fully briefed on the record below, to justify this Court hearing them. Moreover, a due process argument was raised and briefed in the district court. The district court judge apparently ignored it. Petitioners should not be penalized for the judge's failure to certify this challenge to the Attorney General. Moreover, since the issue of constructive fraud is a judicial overlay on the statute, rather than explicit statutory language, there is some question as to whether the Seventh Circuit rationale is even applicable.

### A. A Religious Organization's Right to Free Exercise of Religion Is Violated When Its Property Is Confiscated to Satisfy a Debt of a Debtor with No Legal Relationship to the Religious Organization, Absent Evidence of Wrongdoing by the Latter.

The Petitioners are all Christian ministries, each with a set of religious and charitable purposes that it feels called by God to pursue, with whatever resources God provides. Like most other charities, the ministries do not "earn" their income; they depend on the benevolence of like-minded donors to fund their activities. Unlike other charities, these Christian ministries believe that any income they receive ultimately comes from God, provided to them according to His sovereign grace, and that they have a stewardship obligation to use these provisions to advance their calling. Thus, any government action that substantially restricts the ability of these organizations to freely receive and just as freely distribute their receipts represents a substantial burden on the free exercise of the religious faith of these ministries.

The First Amendment's free exercise clause prohibits the enforcement of any law that imposes a substantial burden on the free exercise of religion, unless it can be justified by a compelling state interest. *Sherbert v. Verner*, 374 U.S. 398, 406; 42 U.S.C. § 2000bb.[17] The burden imposed on the Petitioners in this case is far more than incidental, far more than a reasonable tax. The judgment in this case, and the threat of similar judgments against other religious organizations in the future, imposes a substantial burden on the free exercise of religion.

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[17]Since determination of liability under the fraudulent conveyance laws involves individualized determination regarding whether adequate consideration was given and whether a particular transfer should be exempted from the reach of these laws, the strict scrutiny standard of *Sherbert* should apply. *See Employment Division v. Smith*, 494 U.S. 872, 884 (1990)

If there was any element of wrongdoing, or even negligence, in this process, the government might have a basis for arguing that it has a compelling interest in restricting the right of these charities to receive and distribute charitable donations. But there is not. It might also be suggested that these ministries are not being restricted; after all, they have freely received and spent donations. This argument overlooks the substantial chilling effect that the threat of fraudulent conveyance actions will inevitably have on these (indeed, all) religious organizations. Moreover, this argument ignores the implications of a fraudulent conveyance judgment. By imposing on these charities the requirement to pay a judgment for monies donated and already spent, the court is in effect telling the charities that they need to (1) divert funds from their religious mission to pay the judgment, (2) engage in a special fundraising effort to cover the burden of the judgment, or (3) cease to exist. Regardless, the effect is to interfere in a significant way with the manner in which these ministries carry out their mission. And that violates the constitutional guarantee of free exercise.

### B. Voiding Charitable Donations Places Charities in a Worse Position than Other Entities That Receive Transfers in the Ordinary Course of Business, Violating the Guarantee of Equal Protection.

The Petitioners received Douglas's charitable donations in the normal course of business, and proceeded to distribute them according to their charitable and religious purposes, in the normal course of business. If the charitable donations are now voided, the Petitioners will be in a worse position then before they received the donations.

In contrast, a commercial organization that receives a transfer from Douglas in the ordinary course of business will be left in the same---but no worse---position as before the transfer. If the commercial entity gave reasonably equivalent value, it will not be subject to a fraudulent conveyance action. If it did not give reasonably equivalent value, it will be able to offset any liability by the amount

of the value it gave (see *supra* n.13). Since it is a for-profit entity, the money received from Douglas undoubtedly added to its equity position; it was not given away. Thus, this commercial entity will be left in the same position after a fraudulent conveyance action as before the transfer.

Nonprofit charitable corporations, operating in the normal course of business, however, are placed in a radically different position by the fraudulent conveyance laws than for-profit corporations operating in the normal course of business. Since the charities have done nothing wrong or negligent to justify this disparate treatment, there is no rational basis for their unequal treatment. As applied in this case, the fraudulent conveyance law violates the constitutional guarantee of equal protection.

### C. Confiscating the Property of a Public Charity to Satisfy the Claims of a Creditor Against a Debtor with No Legal Relationship to the Charity Violates Substantive Due Process.

The United States Constitution forbids forfeiture of property from "an owner who was uninvolved in and unaware of the wrongful activity which is the basis of forfeiture and who has done all that reasonably could be expected to prevent proscribed use of his or her property." *United States v. One 1981 Datsun 280ZX*, 644 F. Supp. 1280, 1285 (E.D. Pa. 1986) (citing numerous cases). By imposing a money judgment against the Petitioners, the Seventh Circuit is effecting a forfeiture of their property to redress the claims of Douglas's creditors, despite the fact that the Petitioners (1) were uninvolved in and unaware that Douglas's donations were fraudulent conveyances, and (2) could not reasonably be expected to have done anything else to prevent receipt of fraudulent conveyances. These facts, of course, would not preclude voiding the charitable donations in order to return the property to the debtor's estate. That, however, is not what has happened here. The Petitioners no longer have the fraudulently transferred property and received no proceeds from their subsequent transfer of that property. Therefore, the effect of the

money judgment is to operate as a forfeiture of the Petitioners' property, in violation of the constitutional guarantee of due process.

## CONCLUSION

Because the Seventh Circuit's erroneous construction of the fraudulent conveyance laws threatens the national charitable sector, ignores legislative intent, and gives rise to serious constitutional violations, Petitioners respectfully ask this Court for a writ of certiorari to review the judgment and opinion of the Seventh Circuit Court of Appeals.

Respectfully submitted,

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56 F.3D 750

Steven S. SCHOLES, as Receiver for Michael S. Douglas, D & S Trading Group, Ltd., Analytic Trading Systems, Inc., and Analytic Trading Service, Inc., Plaintiff-Appellee,

v.

Charles LEHMANN and Lisa Lehmann, Joseph E. Phillips, African Enterprise, Inc., et al., Defendants-Appellants.

Nos. 94-2039, 94-2136, 94-2718 and 94-2947.

United States Court of Appeals,
Seventh Circuit.

Argued Feb. 17, 1995.

Decided May 18, 1995.

Rehearing and Suggestion for Rehearing
En Banc Denied July 12, 1995.

Alan S. Rutkoff (argued), Gary L. Prior, Richard L. Sandler, Mary B. Tribby, and Mark T. Ostrowski, McDermott, Will & Emery, Chicago, IL, for plaintiff-appellee.

Eugene Crane, Richard D. Grossman, Dannen, Crane, Heyman & Simon, David A. Shaneyfelt, James A. Davids, Bruce J. Van Heukelem, Hoogendoorn, Talbot, Davids & Godfrey, Chicago, IL, Christopher J. Stoll, Leoris & Cohen, Highland Park, IL, Abraham Brustein, Thomas J. Cunningham (argued) and Thomas G. Jaros, Smith, Williams & Lodge, Joel H. Spitz, Timothy C. Klenk (argued), Jerome K. Bowman, Ross & Hardies, Chicago, IL, Kirk R. McCormick, James J. Murphy, Harris, Karstaedt, Jamison & Powers,

Colorado Springs, CO, Philip R. King, Tribler & Orpett, Chicago, IL, and Wayne Johnson, Heart Cry Intern., Round Lake Beach, IL, for defendants-appellants.

Before POSNER, Chief Judge, and MANION and KANNE, Circuit Judges.

POSNER, Chief Judge.

Michael Douglas masterminded a Ponzi scheme that has given rise to the interesting and important issues of fraudulent-conveyance law which these appeals require us to consider. Here is how the scheme operated (approximately—we shall simplify the facts for the sake of clarity). Douglas created three corporations and caused them in turn to create limited partnerships in which the corporations would be the general partners and would sell limited-partner interests to the investing public. The corporations represented to prospective investors that the limited partnerships would trade commodities and yield the limited partners a return of 10 to 20 percent per month on their investment. Although some trading of commodities was done, most of the money raised from the sale of the limited-partner interests was used simply to pay the promised return. These payments gave the scheme credibility, enabling Douglas to sell additional limited-partner interests. The scheme was launched in 1987 and by the time it crashed in 1989 Douglas's corporations had raised $30 million from the sale of limited-partner interests. Douglas was prosecuted for fraud, pleaded guilty, and is serving a 12-year federal prison sentence.

The Securities and Exchange Commission brought this civil suit against Douglas and his three corporations in 1989, charging multiple violations of federal securities laws. The Commission asked the district court to appoint a receiver for Douglas and the corporations. The court obliged, appointing Steven Scholes of the McDermott firm. To date Scholes has recovered $12 million, consisting mainly of property of Michael Douglas that Douglas had bought with money that he had siphoned from the corporations,

which in turn had obtained the money from the sale of shares in the limited partnerships. The receiver has distributed the recovered funds to the investors in the Ponzi scheme who lost money, with the result that, thus far, each has recovered 40 percent of his losses.

The appeals that we have consolidated for decision arise from the receiver's efforts to recover additional assets from Douglas's ex-wife (Lisa Lehmann) and her husband, from one of the investors in the Ponzi scheme who was lucky enough to make money (Joseph Phillips), and from five religious corporations. The law under which the receiver proceeded is the Illinois law of fraudulent conveyances as it stood in 1989. Ill.Rev.Stat. ch. 59, ¶ 4 (1987). That law was repealed the following year when Illinois adopted the Uniform Fraudulent Transfer Act, 740 ILCS 160, and later we shall consider the possible bearing of the new law on this case. Federal jurisdiction is based on the ancillary jurisdiction of the federal courts, *Pope v. Louisville, New Albany & Chicago Ry.*, 173 U.S. 573, 577, 19 S.Ct. 500, 501, 43 L.Ed. 814 (1899); *Tcherepnin v. Franz*, 485 F.2d 1251, 1255-56 (7th Cir.1973)—now a part of their statutory "supplemental" jurisdiction, 28 U.S.C. § 1367; David D. Siegel, "Practice Commentary," 28 U.S.C.A. § 1367, pp. 829, 830-31 (1993); *Unique Concepts, Inc. v. Manuel*, 930 F.2d 573, 574 (7th Cir.1991), which furnishes the jurisdictional basis for one of the three suits because it was filed after December 1, 1990, the effective date of 28 U.S.C. § 1367. The laying of venue for all three suits in the Northern District of Illinois is authorized by 28 U.S.C. § 754, which allows a receiver to sue in the district in which he was appointed to enforce claims anywhere in the country. The district court granted summary judgment for the receiver against all the defendants and entered judgments of $299,000 against the Lehmanns, $377,000 against Phillips, and $509,000 against the religious corporations.

The (old) fraudulent-conveyance statute provided that "every gift ... or transfer ... made with the intent to disturb, delay, hinder or defraud creditors or other persons ... shall be void as against such creditors ... and other persons." It is apparent from the wording of the

statute, as well as from its purpose, that if a transfer is made for commensurate consideration—if it is "fair" in the sense of being one side of an equal exchange—it is not voidable. For creditors are not disturbed, delayed, hindered, or defrauded if all that happens is the exchange of an existing asset of the debtor for a different asset of equal value. *United States v. Kitsos*, 770 F.Supp. 1230, 1235 n. 14 (N.D.Ill.1991) (interpreting Illinois law), aff'd without opinion, 968 F.2d 1219 (7th Cir.1992); see also *In re Xonics Photochemical, Inc.*, 841 F.2d 198, 202 (7th Cir.1988); *Boston Trading Group, Inc. v. Burnazos*, 835 F.2d 1504, 1513-14 (1st Cir.1987). (Compare the "indubitable equivalent" provision of bankruptcy law. 11 U.S.C. § 1129(b)(2)(A)(iii); *In re James Wilson Associates*, 965 F.2d 160, 172 (7th Cir.1992).) This implies, the defendants argue, that the only transfers reached by the statute are those made without consideration; and they claim that the transfers to them were supported by consideration and therefore that the receiver's suits must fail. We shall get to that, the central issue in these appeals, in a moment, but we must first consider whether receiver Scholes even had standing to bring the suits.

The argument that he did not is that he was "really" suing on behalf not of Douglas or Douglas's corporations, the perpetrator and tools of the Ponzi scheme, respectively, but of the investors, the purchasers of limited-partners interests in the corporations; and a receiver does not have standing to sue on behalf of the creditors of the entity in receivership. Like a trustee in bankruptcy or for that matter the plaintiff in a derivative suit, an equity receiver may sue only to redress injuries to the entity in receivership, corresponding to the debtor in bankruptcy and the corporation of which the plaintiffs are shareholders in the derivative suit. *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416, 92 S.Ct. 1678, 32 L.Ed.2d 195 (1972); *Steinberg v. Buczynski*, 40 F.3d 890, 892 (7th Cir.1994); *Schacht v. Brown*, 711 F.2d 1343, 1346 n. 3 (7th Cir.1983); *Boston Trading Group, Inc. v. Burnazos, supra*, 835 F.2d at 1514-16. How, the defendants ask rhetorically, could the allegedly fraudulent conveyances have hurt Douglas, who engineered them, or the corporations that he had created, that he totally controlled and

probably (the record is unclear) owned all the common stock of, and that were merely the instruments through which he operated the Ponzi scheme?

The answer—so far as the corporations are concerned, and we need go no further—turns out to be straightforward. The corporations, Douglas's robotic tools, were nevertheless in the eyes of the law separate legal entities with rights and duties. They received money from unsuspecting, if perhaps greedy and foolish, investors. That money should have been used for the stated purpose of the corporations' sale of interests in the limited partnerships, which was to trade commodities. Instead Douglas caused the corporations to pay out the money they received to himself, his ex-wife, his favorite charities, and an investor, Phillips, whom Douglas wanted to keep happy, no doubt in the hope that Phillips would invest more money in the Ponzi scheme or encourage others to do so. In the case of the ex-wife, the money went from the corporations first to Douglas and then from him to her, but we cannot see what difference that should make. If the money stopped with Douglas, a certain awkwardness might arise from the fact that Scholes is the receiver both for Douglas and for the corporations which would be suing him for that money. But that is not our case and we need not consider it.

The three sets of transfers removed assets from the corporations for an unauthorized purpose and by doing so injured the corporations. As sole shareholder, Douglas could lawfully have ratified the diversion of corporate assets to noncorporate purposes—but only if creditors were not harmed. *Steinberg v. Buczynski*, *supra*, 40 F.3d at 892; *Dannen v. Scafidi*, 75 Ill.App.3d 10, 30 Ill.Dec. 899, 903, 393 N.E.2d 1246, 1250 (1979). Creditors were harmed. The limited partners were tort creditors of the corporations from which they had been inveigled into buying limited-partner interests, and were, of course (other than Phillips), harmed. "It was not within the power of the shareholders to legalize this waste to the detriment of others." *McCandless v. Furlaud*, 296 U.S. 140, 160, 56 S.Ct. 41, 47, 80 L.Ed. 121 (1935) (Cardozo, J.).

Though injured by Douglas, the corporations would not be heard to complain as long as they were controlled by him, not only because he would not permit them to complain but also because of their deep, their utter, complicity in Douglas's fraud. The rule is that the maker of the fraudulent conveyance and all those in privity with him—which certainly includes the corporations— are bound by it. *Getty v. Hunter*, 166 Ill.App.3d 453, 116 Ill.Dec. 825, 827, 519 N.E.2d 1040, 1042 (1988); *Peric v. Chicago Title & Trust Co.*, 89 Ill.App.3d 271, 44 Ill.Dec. 568, 411 N.E.2d 934 (1980). But the reason, of course, as the cases just cited make clear, is that the wrongdoer must not be allowed to profit from his wrong by recovering property that he had parted with in order to thwart his creditors. That reason falls out now that Douglas has been ousted from control of and beneficial interest in the corporations. The appointment of the receiver removed the wrongdoer from the scene. The corporations were no more Douglas's evil zombies. Freed from his spell they became entitled to the return of the moneys—for the benefit not of Douglas but of innocent investors—that Douglas had made the corporations divert to unauthorized purposes. *McCandless v. Furlaud*, *supra*, 296 U.S. at 159-61, 56 S.Ct. at 47; *Texas & Pacific Ry. v. Pottorff*, 291 U.S. 245, 260-61, 54 S.Ct. 416, 420, 78 L.Ed. 777 (1934); *Southmark Corp. v. Cagan*, 999 F.2d 216, 222 (7th Cir.1993). That the return would benefit the limited partners is just to say that anything that helps a corporation helps those who have claims against its assets. The important thing is that the limited partners were not complicit in Douglas's fraud; they were its victims.

Put differently, the defense of *in pari delicto* loses its sting when the person who is *in pari delicto* is eliminated. *McCandless v. Furlaud*, *supra*, 296 U.S. at 160, 56 S.Ct. at 47; *Albers v. Continental Illinois Bank & Trust Co.*, 296 Ill.App. 596, 17 N.E.2d 67 (1938). Now that the corporations created and initially controlled by Douglas are controlled by a receiver whose only object is to maximize the value of the corporations for the benefit of their investors and any creditors, we cannot see an objection to the receiver's bringing suit to recover corporate assets unlawfully dissipated by Douglas. We cannot see any legal objection and we particularly cannot see any

practical objection. The conceivable alternatives to these suits for getting the money back into the pockets of its rightful owners are a series of individual suits by the investors, which, even if successful, would multiply litigation; a class action by the investors—and class actions are clumsy devices; or, most plausibly, an adversary action, in bankruptcy, brought by the trustee in bankruptcy of the corporations if they were forced into bankruptcy. Concerning this last alternative, it is true that investors, including limited partners in a corporation's investment fund, are not contractual creditors of the corporation, *Allen v. Amber Manor Apartments Partnership*, 95 Ill.App.3d 541, 51 Ill.Dec. 26, 32, 420 N.E.2d 440, 446 (1981); *In re Dutch Inn of Orlando, Ltd.*, 614 F.2d 504 (5th Cir.1980) (per curiam), any more than the corporation's stockholders are. But *defrauded* investors, as we have pointed out, are tort creditors. So Douglas's corporations were insolvent from the outset and could have been petitioned into bankruptcy. Corporate bankruptcy proceedings are not famous for expedition, however; and whatever advantages they may have over receiverships in a case such as this—if any, and none has been pointed out to us—are not ones that the defendants in these fraudulent conveyance actions should be heard to trumpet. Bankruptcy is for the protection of debtors and creditors, and so far as appears no debtors or creditors connected with Douglas's enterprise prefer the bankruptcy route to the receivership route.

We add that if in place of the receiver's actions the investors had brought a class action against the present defendants, or had sued them individually, the defendants would no doubt be arguing that the action was improper because the injury was to the corporations and only derivatively to investors in the corporations. *Hammes v. AAMCO Transmissions, Inc.*, 33 F.3d 774, 777 (7th Cir.1994); *Kagan v. Edison Bros. Stores*, 907 F.2d 690 (7th Cir.1990); *Manson v. Stacescu*, 11 F.3d 1127, 1131 (2d Cir.1993).

We need not consider whether if Douglas had operated as a sole proprietorship rather than through corporations or other legally distinct entities, the receiver could still have maintained these suits.

It could be argued, RICO-fashion, that the Ponzi scheme was a "Douglas enterprise" that Douglas caused to dissipate assets received by the enterprise for investment purposes. We need not decide how good an argument it is, and merely add that we can find no cases in which a receiver for a sole proprietorship recovered a fraudulent conveyance.

So these are proper suits and the next question is whether the transfers should be deemed to fall outside the statute because they were supported by sufficient consideration. Begin with the transfer to Phillips. He invested some $2.5 million in Douglas's scheme, all innocently we may assume, and by exceptional good fortune netted almost $300,000 on his investment. This profit, more precisely the expectation of this profit, was in consideration of Phillips's entrusting his money to Douglas's corporations. Douglas's ex-wife might be able to show that some of the transfers made to her were supported by consideration in the form of a discharge of Douglas's legal obligations to her—obligations of child support and the like arising from their divorce. In the case of the religious associations, which are charitable organizations, it may seem obvious that since charitable *pledges* are often found or deemed to be supported by consideration and therefore legally enforceable, *Allegheny College v. National Chautauqua County Bank*, 246 N.Y. 369, 159 N.E. 173 (1927) (Cardozo, J.); *King v. Trustees of Boston University*, 420 Mass. 52, 647 N.E.2d 1196 (1995); 1 E. Allan Farnsworth, *Contracts* § 2.19 (1990), so must the actual *donation* to the charity. There is support for this proposition, *Dunaway v. First Presbyterian Church*, 103 Ariz. 349, 442 P.2d 93, 95 (1968), but only in the case, which this is not, where the donor is seeking to enforce a condition in his gift. A promise of a gift is a promise nonetheless, and so is a promise to the donor to abide by a condition in the gift; and the enforcement of promises is the office of contract law. The gift itself is not a promise, however; it is a gift. *United States v. American Bar Endowment*, 477 U.S. 105, 118, 106 S.Ct. 2426, 2433, 91 L.Ed.2d 89 (1986).

The statute under which the receiver sued does not say that transfers supported by consideration are outside its reach. It does not have to. A transfer for full in the sense of commensurate consideration cannot (in the ordinary case, anyway) hinder, defraud, or otherwise discomfit creditors, because it is merely replacing one asset with another of equivalent value, as with revolving credit. The point is explicit in the new statute. It states in language virtually identical to the corresponding provision in the Bankruptcy Code, 11 U.S.C. § 548(a)(2), that a transfer will be deemed fraudulent if the debtor made it "without receiving a reasonably equivalent value in exchange for the transfer." 740 ILCS 160/5(a)(2). The transfer must also, under the new statute as under the old, endanger the transferor's solvency. *Gary-Wheaton Bank v. Meyer*, 130 Ill.App.3d 87, 85 Ill.Dec. 180, 186, 473 N.E.2d 548, 554 (1984); 740 ILCS 160/5(a)(2)(A), (B). But that is not a serious issue here, as we shall see.

The requirement of full consideration is implicit in the old statute. Unless the challenged transfer involves a quid pro quo, there is no basis in the statutory language for placing the transfer beyond the statute's reach merely because there is consideration. Consideration and adequate (full, fair, commensurate) consideration are not synonyms. Although some Illinois cases, such as *Till v. Till*, 87 Ill.App.2d 358, 231 N.E.2d 641, 643 (1967), and *Effingham State Bank v. Blades*, 139 Ill.App.3d 259, 93 Ill.Dec. 764, 487 N.E.2d 431 (1985), suggest that a transfer not intended to deceive creditors is fraudulent only if the consideration for it is nonexistent or "grossly" inadequate, the state's highest court has said that inadequacy is enough. *Gendron v. Chicago & North Western Transportation Co.*, 139 Ill.2d 422, 151 Ill.Dec. 545, 553, 564 N.E.2d 1207, 1215 (1990). See also *United States v. Kitsos*, 770 F.Supp. 1230, 1235 n. 14 (N.D.Ill.1991) (interpreting Illinois law); *Lewis v. Superior Court*, 30 Cal.App.4th 1850, 37 Cal.Rptr.2d 63, 79 (1994); *Leonardo v. Leonardo*, 251 F.2d 22, 26 (D.C. Cir.1958).

We can make the distinction between consideration and full consideration perspicuous by noting that the requirement of

consideration serves several purposes in the law of contracts, see Lon Fuller, "Consideration and Form," 41 *Colum.L.Rev.* 799 (1941), in particular a cautionary function of bringing home to the promisor the fact that his promise is legally enforceable and an evidentiary function, important in a legal regime that enforces oral contracts, of making it more likely that an enforceable promise was intended. One purpose the requirement does *not* serve, however, is identifying fair exchanges. Unless fraud or mistake is alleged, ordinarily a court will not even permit inquiry into the adequacy of the consideration for a promise or a transfer. E.g., *Goodwine State Bank v. Mullins*, 253 Ill.App.3d 980, 192 Ill.Dec. 901, 625 N.E.2d 1056, 1079 (1993); *Curtis 1000, Inc. v. Suess*, 24 F.3d 941, 945 (7th Cir.1994). Yet it is only when there is a fair exchange that a transfer which renders the transferor insolvent (or more insolvent) is harmless to his creditors.

What exactly is a fair exchange? Must the transferor at least break even on the exchange? Ordinarily he will do better than break even. No rational nonaltruist makes an exchange without thinking that it will make him better off; the phrase "the gains from trade" expresses the optimistic view that the normal voluntary exchange makes both parties better off. But this is not always true, especially in a setting of alleged fraud, where the defendant may have deliberately given more than he got in return.

To insist that the transferor be made no worse off by the exchange in order to avoid a finding of fraudulent conveyance could be criticized as doing violence to the structure of the statute. As was implicit in the old statute and is explicit in the new one, the statute reaches two kinds of fraud, traditionally called "fraud in fact" and "fraud in law" (sometimes "actual fraud" and "constructive fraud"). We have been discussing the second, in which the plaintiff is not required to prove fraudulent intent. If he does prove fraudulent intent, however, and thus "fraud in fact," then explicitly under the new statute as implicitly under the old the transfer is deemed fraudulent even if it is in exchange for "valuable" consideration. 740 ILCS 160/5(a)(1); *Gendron v. Chicago & North Western Transportation Co.*, *supra*, 564 N.E.2d at 1214-15. There almost

certainly was intent to defraud here on the part of Douglas and through him the corporations, but it is not the basis on which the receiver defends the judgment he obtained in the district court, except with regard to the transfers to the ex-wife, of which more later. If valuable consideration means full consideration, then even if there is intent to defraud there can be no harm to creditors, since the debtor's estate has not been depleted by a cent. So why is there a separate concept of fraud in fact? Why is not fraud in law both a necessary and a sufficient condition for finding a transfer fraudulent?

There are two answers. The first is evidentiary. If the plaintiff proves fraudulent intent, the burden is on the defendant to show that the fraud was harmless because the debtor's assets were not depleted even slightly. If the plaintiff takes the indirect route of proving fraud by proving a lack of full consideration, the burden of proof on the issue of incommensurability of consideration, and hence of the depletion of the debtor's assets, is on him. Cf. *id.* at 1215. Second, if fraudulent intent is proved, then, as we shall see, the defendant, unless he had no knowledge of the transferor's fraudulent intent, must return the entire payment that he received rather than just the amount by which it exceeded the consideration that he gave in exchange for the payment.

We shall come back to fraud in fact. Our present focus is on fraud in law. And here unless a fair in the sense of equal (or at least approximately equal) exchange is insisted upon, loopholes are opened in the fraudulent conveyance statute that can only be described as immoral—a relevant consideration, when we consider the equitable origins of the concept of fraud. We said that Phillips's profit was supported by consideration. But what was the source of the profit? A theft by Douglas from other investors. What then is Phillips's moral claim to keep his profit? None, even if the intent in paying him his profit was not fraudulent. Or less than none. For he argues (seemingly without realizing the implications of the argument) that by continuing to invest in Douglas's corporations he kept them going longer. Yes, and the longer a Ponzi scheme is kept

going the greater the losses to the investors. Phillips was not only lucky; he was an unwitting accomplice of Douglas.

The injustice in allowing Phillips to retain his profit at the expense of the defrauded investors is avoided by insisting on commensurability of consideration. Phillips is entitled to his profit only if the payment of that profit to him, which reduced the net assets of the estate now administered by the receiver, was offset by an equivalent benefit to the estate. *In re Independent Clearing House Co.*, 77 B.R. 843, 857-59 (D. Utah 1987). It was not. A profit is not offset by anything; it is the residuum of income that remains when costs are netted against revenues. The paying out of profits to Phillips not offset by further investments by him conferred no benefit on the corporations but merely depleted their resources faster.

It is no answer that some or for that matter all of Phillips's profit may have come from "legitimate" trades made by the corporations. They were not legitimate. The money used for the trades came from investors gulled by fraudulent representations. Phillips was one of those investors, and it may seem "only fair" that he should be entitled to the profits on trades made with his money. That would be true as between him and Douglas or Douglas's corporations. It is not true as between him and either the creditors of or the other investors in the corporations. He should not be permitted to benefit from a fraud at their expense merely because he was not himself to blame for the fraud. All he is being asked to do is to return the net profits of his investment—the difference between what he put in at the beginning and what he had at the end.

Douglas's ex-wife, to whose case we turn, may well have had some valid claims against her ex-husband. She had no entitlement to have those claims paid by the proceeds of fraud, as would be obvious if Douglas had picked someone's pocket and given the money found there to his ex-wife. But if she had had valid claims against Douglas equal to the amount of money he gave her, so that by giving it to her he received consideration in the form of a release of commensurate legal obligations to her, this would be adequate and not merely

nominal consideration. There would be no net depletion of the estate administered by the receiver, which is the standard of adequacy as we have been articulating it.

The obvious objection to this reasoning is that the ex-wife's claims were claims against Douglas rather than against his corporations, and therefore the release of the claims did not benefit the corporations; they received no consideration for the money they paid out to her (via Douglas). The receiver makes nothing of this distinction, fundamental as it may seem to be. There probably are two reasons for this omission. The first is that the ex-wife's liability—she is a defendant, after all—depends in the first instance on what she gave up in exchange for the money she received rather than to whom that consideration (what she gave up) flowed. Second, the corporations may have been so far controlled by Douglas as to be his alter egos, and therefore (in the absence of other shareholders—an important qualification, elaborated below) liable for his debts. *McCall Stock Farms, Inc. v. United States*, 14 F.3d 1562, 1568-69 (Fed.Cir.1993); *Zahra Spiritual Trust v. United States*, 910 F.2d 240, 245 (5th Cir.1990). Lest the significance of this point be exaggerated, we add that the fact that the corporations were alter egos of Douglas would not affect the receiver's standing to bring these fraudulent conveyance suits. The corporations existed and were abused. They were so abused that Douglas's creditors might have been allowed to pierce the corporate veil and seize the corporations' assets pursuant to what is uncharmingly called the "reverse alter ego" theory of piercing the corporate veil. Direct piercing of the corporate veil occurs when creditors of the corporation are trying to reach the shareholder; reverse piercing occurs when creditors of the shareholder are trying to reach the corporation. Reverse piercing is ordinarily possible only in one-man corporations, since if there is more than one shareholder the seizing of the corporation's assets to pay a shareholder's debts would be a wrong to the other shareholders. Even in one-man corporations it is a rarity because a simple transfer of the indebted shareholder's stock to his creditors will usually give them all they could get from seizing the assets directly. But the only point that is important here is that reverse piercing of Douglas's

corporate veils would not render the corporations incapable of being injured, and that is all that is necessary for these suits to be maintained by the receiver. The question is whether, because the corporations were Douglas's alter egos, they could be made liable for his debts, and we assume the answer is yes.

The objections to the ex-wife's claims lie elsewhere. One objection is the lack of evidence that they were worth what the corporations paid to discharge them. For obvious reasons, judges are particularly insistent upon proof of commensurability when they are dealing with intrafamilial transfers attacked as fraudulent conveyances. *Kardynalski v. Fisher*, 135 Ill.App.3d 643, 90 Ill.Dec. 410, 415, 482 N.E.2d 117, 122 (1985); *United States ex rel. Hartigan v. Alaska*, 661 F.Supp. 727, 729 (N.D.Ill.1987). Douglas's transfers to his ex-wife were lavish, and the principal "obligation" that they are claimed to have discharged was one created by a voluntary settlement that received no judicial scrutiny. Given the scale of the transfers and the family setting, it was the ex-wife's burden to prove that the consideration for the transfers she received was in fact adequate, commensurate. She failed to carry this burden.

There is a difference, though, between her situation and that of Phillips (and also, as we shall see, of the religious associations). Phillips is being asked to give back to the corporations the net amount by which the corporations' assets are smaller as a result of the payment to him of his profits. The ex-wife is being asked to give back all that she received from the corporations even if some of the receipts cancelled a debt that the corporations (as Douglas's alter egos, liable for his debts) owed her. Suppose the valid debt was $100, and she received $1,000; the receiver would be entitled only to $900, for the payment to her of the other $100 conferred a benefit equal to the cost by cancelling the debt of that amount. *Snyder v. Partridge*, 138 Ill. 173, 29 N.E. 851, 854 (1891); *Reagan v. Baird*, 140 Ill.App.3d 58, 94 Ill.Dec. 151, 157, 487 N.E.2d 1028, 1034 (1985). Given the legal obligation of child support in divorce cases, it is unlikely that the ex-wife had no valid claims at all. She was denied an opportunity to prove the amount of those claims. It is plain

that the aggregate transfers made to her exceeded any plausible legal obligation that Douglas or the corporations could have had to her—and hence that the transfers were fraudulent—but we do not know by exactly how much.

This discussion shows that the district judge acted prematurely in granting summary judgment for the receiver against the ex-wife on a theory of "fraud in law" to the full extent of the money received by her. But the receiver, in his second objection to her claim, argues that we can affirm the district court on this point because there was "fraud in fact" as well as in law: Douglas caused the corporations to pay the ex-wife more than he owed her, in a deliberate effort, in which she was complicit, to defraud his and the corporations' other creditors. The evidence, though circumstantial, is strong, cf. *Wilkey v. Wax*, 82 Ill.App.2d 67, 225 N.E.2d 813, 816-17 (1967), but we do not think it is so strong that we can say as a matter of law that there was fraud in fact. Should the district court on remand find actual fraud, this would mean that the ex-wife is not entitled to keep *any* part of the money she received from the corporations—provided, we emphasize, that she knew or should have known of Douglas's fraudulent intent. *Crawford County State Bank v. Marine American National Bank*, 199 Ill.App.3d 236, 145 Ill.Dec. 224, 238-39, 556 N.E.2d 842, 856-57 (1990); *Reagan v. Baird*, *supra*, 487 N.E.2d at 1034; *Second National Bank v. Jones*, 309 Ill.App. 358, 33 N.E.2d 732, 736 (1941) (per curiam); *Baldwin v. Short*, 26 N.E. 928 (N.Y. 1891); *Peoples-Pittsburgh Trust Co. v. Holy Family Polish National Catholic Church*, 341 Pa. 390, 19 A.2d 360 (1941); 740 ILCS 160/9(d). Inadequacy of consideration is not an element of fraud in fact, so that without full restitution the deterrent effect of the fraudulent conveyance law would be greatly weakened. We add that the ex-wife's claims against Douglas, to the extent supported by consideration, would not be extinguished by a finding of actual fraud (and her complicity); they would simply be thrown into the pool with the claims of the other creditors of the corporations, the assets of which would be augmented by the judgment against her. But she would lose the right to keep any part of the money she received out of the pool.

The suits against the religious corporations are the most troublesome, though not because of anything to do with consideration. If one thing is clear, it is that a gift to a charity (to anyone, for that matter) is not in exchange for full in the sense of commensurate consideration. Otherwise it would not be a gift, but an exchange. *United States v. American Bar Endowment*, *supra*, 477 U.S. at 118, 106 S.Ct. at 2433. This principle was applied to a conveyance challenged as fraudulent in *Zahra Spiritual Trust v. United States*, *supra*, 910 F.2d at 248-49.

A thief rushes into a church, and, unobserved by anyone, drops the money he has stolen from his victim into the collection plate. Does the church obtain good title as against the thief's victim? It does not. The case is only slightly more difficult if the "thief" obtained the money by fraud rather than by larceny. A theft cannot pass good title; most frauds can. E.g., *Welch v. Cayton*, 183 W.Va. 252, 395 S.E.2d 496 (1990). The fraudulent conveyance statute, however, would enable the owner to set aside the transfer to the church and recover the money. We do not think that anyone would quarrel with this result. What if, however, the owner does not discover his loss, or where his money has ended up, until the church has spent the money? Shall the church be forced to divert funds from its religious and other charitable activities because a donation that it received in good faith had a tainted source?

One of the religious corporations argues that an affirmative answer would violate the free-exercise clause of the First Amendment, made applicable to the states by the Fourteenth Amendment. The receiver responds that the constitutional issue, not having been raised in the district court, has been waived. The religious corporation points out that there are exceptions to the rule that issues not raised in the district court are waived on appeal. The only one conceivably applicable here is that pure issues of law if fully briefed on appeal will sometimes be addressed by the appellate court notwithstanding the appellant's failure to have raised them below. *Amcast Industrial Corp. v. Detrex Corp.*, 2 F.3d 746, 749-50 (7th Cir.1993). The reason is that in *the type of case put* the failure to have raised the issue in the

lower court will not have prejudiced the opposing party or shifted decisional authority improperly from the trial to the appellate court, since appellate review of pure issues of law is plenary—no weight is given to the lower court's ruling. But a case in which the issue waived is the constitutionality of a statute will rarely be a good candidate for actually applying this exception to the doctrine of waiver. Federal courts should not go out of their way to hamstring the work of legislatures. No doubt in general this principle of deference has diminished force when the challenged legislation has been repealed. But the Illinois fraudulent conveyance law that the religious corporation is challenging, although since repealed, has been replaced by one materially the same, as we have seen. The corporation argues that the old statute is unconstitutional because it has no exception for donations to religion. The argument would apply equally to the new statute, which contains no such exception either.

Federal courts are, or at least ought to be, especially reluctant to invalidate statutes on constitutional grounds by the use of procedural shortcuts, which in this case would involve not only skipping the district court but also denying the Attorney General of Illinois his statutory right to defend the Illinois statute. A district court is required in the case of a challenge to the constitutionality of a state or federal statute to certify the challenge to the state or federal attorney general, respectively, and allow that official an opportunity to intervene and defend the statute. 28 U.S.C. § 2403; *Mox M. v. New Trier High School District No. 203*, 859 F.2d 1297, 1300 (7th Cir.1988). That was not done here, because the constitutional issue was not raised in the district court. We shall not consider it.

The other religious bodies that are defendants in the receiver's fraudulent conveyance suits do not make a constitutional argument. But they do argue that the fraudulent conveyance statute should be interpreted to exclude gifts to religious groups and other charitable organizations, at least when as in this case the ultimate beneficiaries of the fraudulent conveyance suits, the investors in Douglas's Ponzi scheme, are themselves at fault. Only a very foolish, very naive, very

greedy, or very Machiavellian investor would jump at a chance to obtain a return on his passive investment of 10 to 20 percent a month (the Machiavellian being the one who plans to get out early, pocketing his winnings, before the Ponzi scheme collapses). It should be obvious that such returns are not available to passive investors in any known market, save from the operation of luck. And on the other side, these religious corporations spent all the money they received from Douglas on religious and charitable activities. Most of the activities of the defendant religious corporations are missionary endeavors here and abroad, but included as well are earthquake relief in San Francisco and the construction of a chicken hatchery and a children's dormitory in Africa. Since all or virtually all of the corporations' revenues come from donations rather than from sales or other exchanges, they are more exposed to fraudulent conveyance actions than most other entities are; others are more likely to provide full consideration in exchange for the money they receive. At the oral argument of the appeals, concern was expressed, not wholly tongue in cheek, that if the district court's decision stands, charities will have to hold annual "fraud balls" at which they try to raise money to pay judgments in suits brought by persons who claim that some of the money donated to the charity had been obtained from these persons by a fraud or theft by the donor.

An alternative to "fraud balls" would be for charities to screen their donors, but this hardly seems feasible. Another alternative, feasible but costly, would be for charities to hold cash reserves against the possibility of having to disgorge some of their donations in response to claims of fraudulent conveyance. Liability insurance is a possibility, too, but only that. Although one cannot buy insurance against liability for deliberate fraud, the innocent recipient of a fraudulent conveyance is not itself guilty of fraud and so in principle ought to be able to buy insurance. It appears that such insurance is offered, though with limitations that may greatly reduce its value, and perhaps only for conveyances of real estate. See Lawrence D. Coppel & Lewis A. Kann, "Defanging *Durrett*; The Established Law of 'Transfer,' " 100 *Banking L.J.* 676, 677 n. 5 (1983). We do not know whether any religious groups carry such insurance. If not (as

we suspect), the reason may be that the risk to such a group of being sued for the restitution of a fraudulent conveyance is very small, although it did materialize in this case.

The arguments for mitigating the full rigor of the fraudulent conveyance statute with respect to religious associations may be appealing but they are addressed to the wrong body. The statute makes no distinction among different kinds of recipient of fraudulent conveyances. Every kind is potentially liable. (This is true under the new statute as well.) The carving of exceptions is a task better left to the legislature. Statutory draftsmen might for example want to make distinctions based on the degree of negligence of the ultimate beneficiaries of the suit to set aside the fraudulent conveyance. They can do it better than a court can. They could of course authorize courts to engage in an ad hoc balancing of equities, as courts do for example in deciding whether a claim is barred by the equitable defense of laches; and perhaps in this case the balance would incline in favor of the charities. But nothing in the text or history of the Illinois statute or its counterparts in other states provides any purchase for this "interpretation," which would in fact be a radical rewriting of the statute. This is something that judges are understandably reluctant to do, especially when it is a state statute and federal judges.

The religious corporations have a more direct route to their goal. For they argue that the statute does not authorize a money judgment, but only an order— with which they could not comply, having spent the money—directing the rescission of the transfer. The argument is not persuasive. E.g., *Tcherepnin v. Franz*, 489 F.Supp. 43, 45 (N.D.Ill.1980) (interpreting Illinois law); *Spaziano v. Spaziano*, 122 R.I. 518, 410 A.2d 113, 115 (1980). If accepted it would cause recipients (not limited to charities) of gifts and other transfers potentially voidable under the fraudulent conveyance statute to spend the money immediately, in an effort (perhaps doomed anyway, cf. *United States v. Ginsburg*, 773 F.2d 798 (7th Cir.1985) (en banc)) to prevent tracing. The result would be the frustration of the statutory purpose.

The remaining issues mainly concern deficiencies in the record upon which the district judge based his conclusion that there was no genuine issue of material fact concerning the defendants' liability. To show that the transfers to the defendants were fraudulent within the meaning of the statute, the receiver had to show that, when each of the transfers was made, Douglas's corporations had creditors to hinder, defraud, and so forth and that the transfers jeopardized the corporations' solvency. The receiver also had to show that the money transferred to the defendants came from the corporations rather than from Douglas himself—for remember that the receiver is suing to recover corporate assets. The evidence on which the district judge relied consisted mainly of the criminal indictment against Douglas, his guilty plea and plea agreement, his deposition taken in the SEC's suit out of which the receivership arose, and the affidavit of an accountant who studied the books of the corporations and of Douglas himself.

The defendants point out that the indictment was inadmissible (an indictment is not evidence of the charges contained in it, any more than a complaint is), that the deposition was unsigned and contradicted by subsequent affidavits of Douglas, and that the accountant's affidavit was not notarized and (they argue) not based on the accountant's personal knowledge. But so what? Irregularities in evidence are material only when material facts are disputable and disputed; otherwise they are harmless error and can be ignored. *New England Anti-Vivisection Society v. United States Surgical Corp.*, 889 F.2d 1198, 1204 (1st Cir.1989); *Carter v. Western Reserve Psychiatric Habilitation Center*, 767 F.2d 270, 273 n. 2 (6th Cir.1985). It is indisputable that when Douglas emerged from prison, where he had been serving a term for a previous fraud, in 1987, he had a negative net worth and that within a few months of modest lawful employment had launched his Ponzi scheme, to which his entire energies were devoted until its collapse; it was during this period that all the transfers to the defendants were made. Douglas's income during this period consisted almost entirely of money that he either withdrew from the corporations or earned on the money withdrawn. The corporations' money consisted either of money

obtained from the fraudulent sale of limited partnerships or earnings on that money, and obviously any diversion of these fraudulently obtained assets to Douglas was improper. Any income that he obtained from these assets likewise belonged to the corporation from which he had wrongfully withdrawn them. The thief is not entitled to the interest or profits on the principal that he steals.

Although Douglas claims to have had some legitimate income, he has failed to specify source or amount, and we can safely assume that it was *de minimis*, that virtually all the money for the transfers came either directly or indirectly from assets that belonged to the corporation; and the transfers defrauded creditors consisting of the purchasers of the limited-partnership interests, who were tort creditors of the corporations. The fact that they did not know yet that they had been victimized did not detract from their status as tort creditors. *Eby v. Ashley*, 1 F.2d 971, 973 (4th Cir.1924); *Rosenberg v. Collins*, 624 F.2d 659, 664-65 (5th Cir.1980); *In re Independent Clearing House Co.*, *supra*, 77 B.R. at 857. These claims of which the holders were not yet conscious made the corporations insolvent from the beginning. And, as we have seen, the transfers were not supported by adequate consideration.

Taken together, the facts just recited, most of which come right out of Douglas's plea agreement, which was admissible though hearsay, Fed.R.Evid. 803(22), and of which the district court properly took judicial notice under Fed.R.Evid. 201, see *Green v. Warden*, 699 F.2d 364, 369 (7th Cir.1983); *Colonial Penn Ins. Co. v. Coil*, 887 F.2d 1236 (4th Cir.1989); *Veg-Mix, Inc. v. U.S. Dept. of Agriculture*, 832 F.2d 601, 607 (D.C. CIR.1987), established the defendants' liability (with the partial exception of the ex-wife). It is true that in affidavits submitted to the district court Douglas tried to backpedal from the admissions in his plea agreement. But just as an affidavit in which a witness tries to retract admissions that he made earlier in his deposition is normally given no weight in a summary judgment proceeding, *Russell v. Acme-Evans Co.*, 51 F.3d 64, 67 (7th Cir.1995), so a witness should not be permitted by a subsequent affidavit to retract admissions in a plea agreement. *Local 167 of Int'l*

*Brotherhood of Teamsters v. United States*, 291 U.S. 293, 54 S.Ct. 396, 78 L.Ed. 804 (1934); *Hardin v. Aetna Casualty & Surety Co.*, 384 F.2d 718, 719 (5th Cir.1967) (per curiam). Admissions—in a guilty plea, *Country Mutual Ins. Co. v. Duncan*, 794 F.2d 1211, 1215 (7th Cir.1986), as elsewhere—are admissions; they bind a party; and the veracity safeguards surrounding a plea agreement that is accepted as the basis for a guilty plea and resulting conviction actually exceed those surrounding a deposition.

The only other issue in these appeals is whether the judgments should be reversed because the district judge received in the course of the proceedings a number of letters, which he described as "very sad," from investors in the Ponzi scheme. These letters had no bearing on the legal issues, and there is no indication that the district judge was swayed by them. Judges are not sequestered, and do not have to recuse themselves because someone not a party, but interested financially or otherwise in a litigation, writes something about the case which the judge reads. *United States v. Hillsberg*, 812 F.2d 328, 335 (7th Cir.1987); *United States v. Burger*, 964 F.2d 1065, 1069-70 (10th Cir.1992); *State v. Bromwich*, 213 Neb. 827, 331 N.W.2d 537, 541 (1983); cf. *In re Larson*, 43 F.3d 410 (8th Cir.1994). At some point receipt of unauthorized communications about a case might so affect the impartiality of the judge or the appearance of impartiality that he would have to recuse himself. *United States v. Sciuto*, 531 F.2d 842, 846 (7th Cir.1976). But that point is far from having been reached here.

The judgment of the district court is affirmed except for the summary judgment in the suit against the ex-wife and her husband, as to which further proceedings on remand are necessary.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.

**United States Court of Appeals**

For the Seventh Circuit

Chicago, Illinois 60604

July 12, 1995

Before

Hon. Richard A. Posner, Chief Judge
Hon. Daniel A. Manion, Circuit Judge
Hon. Michael S. Kanne, Circuit Judge

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STEVEN S. SCHOLES,
as Receiver for Michael S. Douglas,
D&S Trading Group, Ltd., Analytic Trading Systems, Inc. and
Analytic Trading Services, Inc.
*Plaintiff - Appellee,*

v

CHARLES LEHMANN AND LISA LEHMANN,
JOSEPH E. PHILLIPS,
AFRICAN ENTERPRISES, INC., et. al.,
*Defendants-Appellants.*

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**ORDER**

On June 1, 1995, defendants-appellants filed petitions for rehearing with suggestions for rehearing en banc. All the judges on the original panel have voted to deny the petitions, and none of the active judges has requested a vote on the suggestions for rehearing en banc. The petitions are therefore DENIED.

854 F.Supp. 1315

Steven S. SCHOLES, not individually but solely as Receiver for Michael S. Douglas, D & S Trading Group, Ltd., Analytic Trading Systems, Inc., Analytic Trading Service, Inc., and Market Systems, Inc., Plaintiff,

v.

AFRICAN ENTERPRISE, INC., Bethany Evangelical Free Church, Heart Cry International, Hindustan Bible Institute, Inc., International Students, Inc., Proclamation International, Inc., and World Vision, Inc., Defendants.

No. 90 C 3989.

United States District Court,
N.D. Illinois,
Eastern Division.

June 21, 1994.

Wilber H. Boies, Gary L. Prior, Richard Lawton Sandler, Jane M. Simon, Michael V. Hughes, Mary B. Tribby, Mark Thomas Ostrowski, McDermott, Will & Emery, Ruta K. Stropus, Sachnoff & Weaver, Ltd., Chicago, IL, for Steven S. Scholes.

Catherine Patricia Wassberg, Jenner & Block, Timothy C. Klenk, Jerome Kiley Bowman, Ross & Hardies, P.C., Chicago, IL, for African Enterprise, Inc., Bethany Evangelical Free Church, Food for the Hungry, Inc., Hindustan Bible Institute, Inc., International Students, Inc., Proclamation Intern., Inc., Trinity College, Trinity Evangelical Divinity School.

Robert Ronald Tepper, Law Offices of Robert R. Tepper, Chicago, IL, for Camp Elim and Other Youth Ministries of Haiti.

Paul B. Newman, Newaygo, MI, for Gospel Revival Ministries.

Scott H. Kenig, Holleb & Coff, Chicago, IL, for Heart Cry Intern.

C. William Bockelman, Jr., O'Neill & Bockelman, P.C., Lake Forest, IL, Scott H. Kenig, Holleb & Coff, Chicago, IL, for Lake Forest Academy, Calvary Chapel of Chula Vista.

Timothy C. Klenk, Jerome Kiley Bowman, Ross & Hardies, P.C., Chicago, IL, for World Vision, Inc.

James A. Davids, Bruce J. Van Heukelem, Hoogendoorn, Talbot, Davids, Godfrey & Milligan, Chicago, IL, H. Robert Showers, Peter Rathbun, Gammon & Grange, P.C., McLean, VA, for Camp Forest Springs.

***MEMORANDUM OPINION AND ORDER***

ALESIA, District Judge.

This case arises out of a fraudulent investment scheme perpetrated by Michael S. Douglas ("Douglas") from August 1987 to November 1989. At issue are monetary conveyances made by Douglas, during the pendency of the fraudulent investment scheme, to the defendants, all of which are non-profit corporations. Plaintiff Steven S. Scholes, as Receiver for the defunct investment entities, named sixteen defendants in his First Amended Complaint. Many defendants have settled the claims. Summary Judgment motions are pending against and on behalf of the following seven remaining defendants: (1) Bethany Evangelical Free Church ("Bethany"), (2) World Vision, Inc. ("World Vision"), (3) Proclamation International, Inc. ("Proclamation"), (4) International Students, Inc. ("International Students"), (5) Hindustan Bible Institute, Inc. ("Hindustan"), (6)

African Enterprise, Inc. ("African Enterprise") and (7) Heart Cry International ("Heart Cry"). Scholes asserts claims for fraudulent conveyance and unjust enrichment against each.

Presently before the court are (1) the Receiver's Motion for Summary Judgment Against Hindustan Bible Institute, Inc., International Students, Inc., and Proclamation International, Inc., (2) the Receiver's Motion for Summary Judgment Against African Enterprise, Inc. and Bethany Evangelical Free Church, (3) the Receiver's Motion for Summary Judgment Against Heart Cry International and World Vision, Inc., (4) Motion of Certain Defendants [namely African Enterprise, Hindustan, International Students, and World Vision] for Summary Judgment, and (5) Motion for Summary Judgment of Proclamation International, Inc. and Bethany Evangelical Free Church.

## *I. FACTS*

From August 1987 until November 13, 1989, Douglas and others perpetrated a massive securities fraud, for which Douglas was indicted on June 19, 1990. (certified copy of Indictment (hereinafter "Indictment"), Exhibit A, Reply Mem. In Supp. of Receiver's Mot. for Summ. J. Against African Enterprise, Inc. and Bethany Evangelical Free Church (hereinafter "AE Reply Memo")) The Indictment charged Douglas with seven counts of mail fraud and one count of providing false information to the United States government. On January 11, 1991, Douglas was convicted, pursuant to a guilty plea, of three counts of mail fraud and one count of providing false information to the government, and was sentenced to 12 years in prison. (AE Reply Memo, Exhibit B (certified copy of Judgment in a Criminal Case); Plea Agreement in *United States v. Michael S. Douglas*, case No. 90 CR 557 (N.D.Ill. October 4, 1990) (hereafter "Plea Agreement"))

Douglas operated the scam by purporting to sell limited partnership interests in three entities now in receivership: D & S

Trading Group, Ltd. ("D & S"), Analytic Trading Systems, Inc. ("AT Systems") and Analytic Trading Service, Inc. ("AT Service"). (Pl.'s Stmt. of Material Facts as to Which There is No Genuine Issue with Respect to Hindustan Bible Institute, Inc., International Students, Inc., and Proclamation International, Inc. (hereafter "Pl.'s Hindustan 12(m) Stmt."), at ¶ 5) Douglas had effective control over each of these entities. (*Id.*; *see* Dep. Transcript of Douglas (hereafter "Douglas Dep."), pp. 364-65, attached as Exhibit F to the Statement of Material Facts as to which There Is No Genuine Issue With Respect to Heart Cry International, and World Vision, Inc. (hereinafter "Pl.'s Heart Cry 12(m) Stmt.")) Douglas misappropriated funds from these entities and provided public investors with false and misleading information concerning them. (Pl.'s Hindustan 12(m) Stmt., ¶ 6; Plea Agreement ¶ 5) Douglas funded the withdrawal of certain investors' capital and income with other investors' capital, in a classic Ponzi scheme. (*Id.*)

In January 1987, Douglas was released from incarceration after being convicted on charges relating to previous fraudulent activity. (Douglas Dep., pp. 24, 26-27) Prior to this time, Douglas had been in dire financial straits. (*See* certified copy of Affidavit of Assets and Liabilities of Michael Douglas, attached to AE Reply Memo as Exhibit C) At the time of his release in January 1987, Douglas, by his own admission, had a negative net worth. (Douglas Dep., pp. 39, 53) Douglas had unpaid judgments totalling $28,166.06 outstanding against him upon his release. (*See* certified copy of Judgments attached to AE Reply Memo as Exhibit D) None of those judgments has been satisfied. (*See* Docket Sheets attached to AE Reply Memo as Exhibit E)

From the time he was released from incarceration in January 1987 until the formation of D & S in August 1987, Douglas held two jobs, one with Computerland and one with San Gregorio Partners. (Douglas Dep., pp. 53-55) During this period of time, Douglas earned $3,512.48 from Chicago Metropolitan Computers, Inc. and $6,548.00 from San Gregorio Partners. (*See* Pl.'s Heart Cry 12(m) Stmt., Exhibit I (1987 federal tax return of M.S. Douglas and J.T.

Douglas, pp. 19-20)) Thus, at the time Douglas started D & S he had a negative net worth of at least $18,105.58--the total of the judgments outstanding against him at the time less his total gross compensation of $10,060.48 from the time he was released until he began D & S.

Douglas embezzled, converted and diverted investor funds from D & S, AT Systems and AT Service. (Pl.'s Hindustan 12(m) Stmt., at ¶ 10; *see also* Exhibit A, Affidavit of [the accountant retained by the Receiver,] Richard A. Mark (hereinafter "Mark Affidavit"), attached thereto, at ¶ 3; Plea Agreement ¶ 5) From August 1987 until November 13, 1989, the date the SEC shut Douglas down, Douglas had no source of income other than the money he took from D & S, AT Systems, AT Service and investors. (Douglas Dep., pp. 56-58; Mark Affidavit, ¶ 3) All of Douglas' "net worth" as of November 30, 1989, the date the Receiver was appointed, was attributable to monies Douglas diverted from D & S, AT Systems and AT Service. (Douglas Dep., pp. 57-58; Mark Affidavit, ¶ 3) According to the affidavit of Mr. Mark, the accountant retained by the Receiver, from August 1987 through November 1989 Douglas was insolvent both in the sense that his liabilities exceeded his assets and in the sense that he was unable to pay his debts as they came due. (Mark Affidavit, ¶ 3) Furthermore, according to the Receiver, Douglas failed to retain sufficient property to pay his creditors. (*See* Affidavit of Steven S. Scholes, attached as Exhibit B to Pl.'s Hindustan 12(m) Stmt. (hereinafter "Scholes Affidavit"), at PP 2, 3)

Douglas operated D & S, AT Systems and AT Service in sequence. (Pl.'s Hindustan 12(m) Stmt., at ¶ 11) D & S operated from August 1987 until October 1988. (*Id.*; Douglas Dep., pp. 52, 157-58, 165) D & S purported to be a limited partnership in which interests were sold to the public. (Douglas Dep., pp. 157-58; Plea Agreement ¶ 5) Douglas was held out to be a general partner of D & S. (Douglas Dep., p. 158; Plea Agreement ¶ 5) Numerous investors in D & S executed limited partnership agreements titled "Articles of Limited Partnership Establishing D & S Trading Group, Ltd." (Pl.'s Heart Cry 12(m) Stmt., Exhibit K, at ¶ 2) D & S, however, was never in fact

formed as a limited partnership. (*See* Pl.'s Heart Cry 12(m) Stmt., Exhibit L)

Douglas knew in August 1987 that D & S was not properly registered with regulatory authorities. (Douglas Dep., pp. 270-71; Plea Agreement ¶ 5) From the inception of D & S, Douglas misappropriated monies from D & S and used them for his personal purposes, but he did not replace the funds and he did not disclose the diversions to investors. (Douglas Dep., pp. 193-99; Mark Affidavit, ¶ 3; Plea Agreement ¶ 5) Douglas knew these diversions were illegal. (Douglas Dep., pp. 199-200)

AT Systems began operations in approximately September 1988, simultaneous with the closing of D & S. (Mark Affidavit, PP 4, 5) Douglas was an officer, sole shareholder of, and person with control over, AT Systems. (Douglas Dep., pp. 249-50) Substantially all the funds invested in D & S were reinvested in AT Systems. (Douglas Dep., pp. 316-17) AT Systems purportedly was the corporate managing general partner of a limited partnership, in which interests were sold to the public. (Douglas Dep., p. 257) Numerous investors in AT Systems executed limited partnership agreements titled "ATS Fund I Limited Partnership." (Pl.'s Heart Cry 12(m) Stmt., Exhibit K, at ¶ 3) However, no such limited partnership was in fact ever formed. (*See Id.*, Exhibit M, at ¶ 3) AT Systems operated until approximately September 1989, when AT Service began operations. (Douglas Dep., p. 267) Douglas closed AT Systems out of fear that the SEC was going to shut down AT Systems because the interests it was selling were not properly registered. (Douglas Dep., pp. 268-71)

Douglas knew from the inception of AT Systems that the securities AT Systems was selling were required to be registered. (Douglas Dep., p. 271) As he did with D & S, Douglas diverted AT Systems money to his own use from the inception of AT Systems (Douglas Dep., pp. 290-91, 322, 380-81; Mark Affidavit, ¶ 3), despite the fact that he knew the diversions were illegal. (Douglas Dep., p. 317) Approximately $4.1 million of the funds initially raised through AT

Systems was transferred to D & S to fund the close-out of all D & S accounts. (Plea Agreement ¶ 5)

AT Service began operations in approximately September 1989. (Mark Affidavit, ¶ 6) Douglas had the same control and authority over AT Service that he had with respect to AT Systems. (Douglas Dep., pp. 364-65) Douglas was aware that the SEC was investigating AT Systems (Douglas Dep., p. 340), and Douglas desired to funnel former D & S and AT Systems investors and capital into an entity that was unknown to the SEC and with which he would not be connected as an officer, director, employee, or shareholder. (Douglas Dep., pp. 316-17, 326-27, 340, 343) Substantially all the funds invested in AT Systems were reinvested in AT Service. (Douglas Dep., p. 343) AT Service purportedly was the corporate managing general partner of a limited partnership, in which interests were sold to the public. (Douglas Dep., pp. 341-43) Numerous investors in AT Service executed limited partnership agreements titled "ATS Arbitrage Fund I Securities Trading Partnership," and "ATS Discretionary Fund II Securities Trading Partnership." (Pl.'s Heart Cry 12(m) Stmt., Exhibit K, PP 4 and 5) However, no such limited partnerships were in fact ever formed. (*See Id.*, Exhibit N) AT Service operated until November 13, 1989, when the SEC shut it down. (Douglas Dep., p. 366)

Douglas knew during all relevant times that AT Service was not properly registered with regulatory authorities. (Douglas Dep., pp. 270-71; Plea Agreement ¶ 5) Douglas misappropriated monies from AT Service and used them for his personal purposes.. (Mark Affidavit, ¶ 3) During the time Douglas was conducting this fraud, he diverted in excess of $1.5 million which he contributed to several charities in his own name, as follows.

***HINDUSTAN BIBLE INSTITUTE, INC.***

Hindustan is a California non-profit corporation with its principal place of business in Union Hills, North Carolina. (See Pl.'s Hindustan 12(m) Stmt., Exhibit D (Affidavit of Paul R. Gupta, PP 3,

4)) Douglas made the following charitable contributions to Hindustan on the respectively indicated dates:

| Date | Dollar Amount |
|---|---|
| April 19, 1988 | 1,000.00 |
| May 10, 1988 | 50.00 |
| August 4, 1988 | 300.00 |
| September 21, 1988 | 21.00 |
| September 26, 1988 | 100.00 |
| October 27, 1988 | 100.00 |
| December 15, 1988 | 100.00 |
| January 17, 1989 | 100.00 |
| February 1, 1989 | 100.00 |
| March 7, 1989 | 100.00 |
| March 14, 1989 | 5,000.00 |
| March 14, 1989 | 10,000.00 |
| March 31, 1989 | 100.00 |
| April 21, 1989 | 100.00 |
| May 11, 1989 | 100.00 |
| May 25, 1989 | 100.00 |
| June 5, 1989 | 50,000.00 |
| June 30, 1989 | 100.00 |
| July 13, 1989 | 5,257.79 |
| August 18, 1989 | 100.00 |
| September 28, 1989 | 100.00 |
| October 25, 1989 | 2,060.46 |
| Total: | $74,989.25 |

(*See* Pl.'s Hindustan 12(m) Stmt., Exhibit C) Hindustan deposited the monies it received from Douglas into Hindustan's account at Bank of America, account no. 2111-1930. (Pl.'s Heart Cry 12(m) Stmt., Exhibit Q; Pl.'s Hindustan 12(m) Stmt., Exhibit G) The monies transferred to Hindustan were monies Douglas obtained from D & S, AT Systems and AT Service. (Douglas Dep., pp. 1800-03)

Given that all Douglas' income from August 1987 to November 1989 was derived from D & S, AT Systems and AT Service (Douglas Dep., pp. 56-58), the funds transferred to Hindustan were monies originating from one or more of those entities.

In exchange for the transfers it received from Douglas, Hindustan provided no more than "an express or implied promise that his donation would be used for the tax-exempt purposes of [Hindustan] and, more specifically, for the purpose or purposes for which he designated his donations." (*See* Pl.'s Hindustan 12(m) Stmt., Exhibit H (Hindustan's Resp. to Int. No. 2, at pp. 5-6)) Hindustan provided no cash or other assets in exchange for the transfers. (Mark Affidavit, ¶ 7) Douglas claimed the transfers he made to Hindustan in 1988 as a deduction for charitable contributions on his 1988 federal income tax return. (*See* Pl.'s Heart Cry 12(m) Stmt., Exhibit R at p. 19) Hindustan provided Douglas with receipts for the contributions, acknowledging the transfers as "tax deductible." (*See* Pl.'s Hindustan 12(m) Stmt., Exhibit I (Hindustan Tax Receipts))

***INTERNATIONAL STUDENTS, INC.***

International Students is a Colorado not-for-profit corporation located in Colorado Springs, Colorado. (See Pl.'s Hindustan 12(m) Stmt., Exhibit J (Affidavit of Gordon Loux, at ¶ 2)) Douglas made the following charitable contributions to International Students on the respectively indicated dates:

| Date | Dollar Amount |
|---|---|
| September 1, 1987 | 100.00 |
| October 1, 1987 | 100.00 |
| October 28, 1987 | 100.00 |
| October 30, 1987 | 1,200.00 |
| October 30, 1987 | 1,000.00 |
| December 2, 1987 | 100.00 |
| December 31, 1987 | 100.00 |
| January 4, 1988 | 100.00 |

| | |
|---|---|
| January 15, 1988 | 100.00 |
| January 28, 1988 | 100.00 |
| March 21, 1988 | 200.00 |
| March 21, 1988 | 50.00 |
| April 13, 1988 | 200.00 |
| May 2, 1988 | 200.00 |
| May 31, 1988 | 200.00 |
| July 1, 1988 | 200.00 |
| August 18, 1988 | 200.00 |
| September 23, 1988 | 200.00 |
| October 19, 1988 | 200.00 |
| November 1, 1988 | 1,000.00 |
| November 14, 1988 | 1,000.00 |
| December 5, 1988 | 1,000.00 |
| December 12, 1988 | 1,000.00 |
| January 6, 1989 | 1,000.00 |
| January 30, 1989 | 1,000.00 |
| April 5, 1989 | 1,000.00 |
| April 6, 1989 | 100.00 |
| April 24, 1989 | 100.00 |
| April 24, 1989 | 1,000.00 |
| April 28, 1989 | 100,000.00 |
| August 25, 1989 | 5,000.00 |
| August 25, 1989 | 200.00 |
| September 25, 1989 | 1,000.00 |
| September 25, 1989 | 200.00 |
| October 16, 1989 | 1,000.00 |
| October 16, 1989 | 200.00 |
| Total | $120,450.00 |

(*See* Pl.'s Hindustan 12(m) Stmt., Exhibit C, ¶ 157; Exhibit J, PP 8, 10, 12; Exhibit K (International Students' internal list of Douglas' donations); Exhibit L (copies of checks)) International Students deposited the monies into its account at First National Bank,

Colorado Springs, Colorado, account no. 007799100. (*See Id.*, Exhibit L)

The monies transferred to International Students were monies Douglas obtained from D & S, AT Systems and AT Service. Given that all Douglas' income from August 1987 to November 1989 was derived from D & S, AT Systems and AT Service, all the funds transferred to International Students were monies originating from one or more of those entities. (Douglas Dep., pp. 56-58, 1796-97)

In exchange for the transfers it received from Douglas, International Students provided no more than "an express or implied promise that his donation would be used for the tax-exempt purposes for which he designated his donations." (Pl.'s Hindustan 12(m) Stmt., Exhibit M (Resp. to Int. No. 2, at p. 6)) International Students provided no cash or other assets in exchange for the transfers. (Mark Affidavit, ¶ 7) Douglas claimed substantially all of the transfers made in 1988 as a deduction for charitable contributions on his 1988 federal income tax return. (*See* Pl.'s Heart Cry 12(m) Stmt., Exhibit R, at p. 19)

***PROCLAMATION INTERNATIONAL, INC.***

Proclamation is a non-profit Florida corporation located in Pensacola, Florida. (*See* Pl.'s Hindustan 12(m) Stmt., Exhibit N (Affidavit of Donald Dunkerley, PP 2-3)) Beginning in approximately December 1988, Douglas was a member of Proclamation's "Advisory Board." (*See Id.*, Exhibit O (December 14, 1988 letter to Douglas from Dunkerley and memo to "PI Board and Advisors" from Dunkerley)) Douglas made the following charitable contributions to Proclamation on the respectively indicated dates:

| Date | Dollar Amount |
|---|---|
| November 9, 1987 | 753.13 |
| February 18, 1988 | 2,500.00 |
| September 20, 1988 | 6,000.00 |

| | |
|---|---|
| December 4, 1988 | 3,000.00 |
| December 4, 1988 | 5,000.00 |
| January 1, 1989 | 9,500.00 |
| February 13, 1989 | 11,475.00 |
| March 29, 1989 | 8,500.00 |
| Total: | $46,728.13 |

(*See Id.*, Exhibit C, ¶ 223; Exhibit P (Douglas checks payable to Proclamation); Pl.'s Heart Cry 12(m) Stmt., Exhibit Q, p. 13 (check no. 925), p. 14 (check no. 976)) Proclamation deposited the monies it received from Douglas into Proclamation's account at Citizens and Peoples National Bank, account no. 1011337. (Pl.'s Hindustan 12(m) Stmt., Exhibit P; Pl.'s Heart Cry 12(m) Stmt., Exhibit Q, p. 13 (check no. 925), p. 14 (check no. 976))

Patrick Grady, a salesperson for Douglas in connection with the sale of purported limited partnership interests in D & S, AT Systems and AT Service, received diverted assets from one or more of the receivership entities, which Grady in turn transferred to Proclamation on the following dates in the respectively indicated amounts:

| Date | Dollar Amount |
|---|---|
| January 28, 1988 | 2,000.00 |
| March 28, 1988 | 2,500.00 |
| Total: | $4,500.00 |

(*See* Pl.'s Hindustan 12(m) Stmt., Exhibit C, ¶ 224; Exhibit Q (dep. transcript of P. Grady, pp. 67-69, 169, 173); Exhibit R (checks issued to Proclamation by Grady with corresponding receipts); Exhibit S (1988 federal tax return of Patrick Grady)) Proclamation deposited the monies it received from Douglas through Grady in

Proclamation's account at Citizens and Peoples National Bank in Pensacola, Florida, account no. 1011337. (*Id.*, Exhibit R)

The monies Douglas transferred to Proclamation, directly and indirectly through Grady, were monies Douglas obtained from D & S, AT Systems and AT Service. (*Id.*, Exhibit Q; Douglas Dep., pp. 1782-84) Given that all Douglas' income from August 1987 to November 1989 was derived from D & S, AT Systems and AT Service (Pl.'s Heart Cry 12(m) Stmt., Exhibit F, at pp. 56-58), the funds Douglas transferred to Proclamation, directly and indirectly through Grady, were monies originating from one or more of those entities.

In exchange for the transfers it received from Douglas, directly and indirectly through Grady, Proclamation provided no more than "an express or implied promise that his donation would be used for the tax-exempt purposes of [Proclamation] and, more specifically, for the purpose or purposes for which he designated his donations." (*See* Pl.'s Hindustan 12(m) Stmt., Exhibit T (Resp. to Int. No. 2, at p. 6)) Proclamation provided no cash or other assets in exchange for the transfers. (Mark Affidavit, ¶ 7) Douglas claimed at least the 1988 transfers as a deduction for charitable contributions on his 1988 federal income tax return. (*See* Pl.'s Heart Cry 12(m) Stmt., Exhibit R, at p. 19) Grady claimed both contributions he made to Proclamation as deductions for charitable contributions on his 1988 federal income tax return. (*Id.*, Exhibit Q, p. 173; Exhibit S, p. 4)

***HEART CRY INTERNATIONAL***

Douglas made the following charitable contributions to Heart Cry on the respectively indicated dates:

| Date | Dollar Amount |
|---|---|
| October 4, 1988 | 11,485.00 |
| March 1989 | 1,000.00 |

| | |
|---|---|
| Total: | $12,485.00 |

(*See* Pl.'s Heart Cry 12(m) Stmt., ¶ 24) Heart Cry deposited the monies it received from Douglas into Heart Cry's account at First of America Bank, account no. 0902468801. (*Id.* ¶ 25) The monies transferred to Heart Cry were monies obtained from D & S, AT Systems and AT Service. (*Id.* ¶ 26) Given that all Douglas' income from August 1987 to November 1989 was derived from D & S, AT Systems and AT Service, the funds transferred to Heart Cry were monies originating from one or more of those entities. Douglas claimed at least the October 4, 1988 transfer as a deduction for a charitable contribution on his 1988 federal income tax return. (*Id.*)

***WORLD VISION, INC.***

Douglas made the following charitable contributions to World Vision on the respectively indicated dates.

| Date | Dollar Amount |
|---|---|
| March 16, 1988 | 7,500.00 |
| April 23, 1989 | 25,000.00 |
| October 20, 1989 | 25,000.00 |
| Total: | $57,500.00 |

(Pl.'s Heart Cry 12(m) Stmt., ¶ 37) World Vision deposited the monies it received from Douglas into its accounts at Bank of America, account no. 14620- 01562 (*Id.* ¶ 38) The monies transferred to World Vision were monies Douglas obtained from D & S, AT Systems and AT Service. (*Id.* ¶ 39) Given that all Douglas' income from August 1987 to November 1989 was derived from D & S, AT Systems and AT Service all the funds transferred to World Vision were monies originating from one or more of those entities.

For the transfers it received from Douglas, World Vision purportedly provided "an express or implied promise that his donation would be used for the tax exempt purpose of [World Vision] and, more specifically, for the purpose or purposes for which he designated his donations." (*Id.* ¶ 40)

World Vision provided Douglas with at least two "tax deductible receipts," one each for the April 23, 1989 and October 20, 1989 conveyances. (*Id.* ¶ 41) Douglas claimed the March 16, 1988 transfer as a deduction for a charitable contribution on his 1988 federal income tax return. (*Id.*)

***BETHANY EVANGELICAL FREE CHURCH***

Douglas made the following charitable contributions to Bethany on the respectively indicated dates.

| Date | Dollar Amount |
|---|---|
| December 8, 1988 | 3,500.00 |
| March 8, 1989 | 16,380.00 |
| June 11, 1989 | 1,000.00 |
| September 27, 1989 | 5,000.00 |
| September 1989 | 1,000.00 |
| Total: | $26,880.00 |

(Pl.'s African Enterprise 12(m) Stmt., ¶ 27) Bethany deposited the December 8, 1988, March 8, 1989, June 11, 1989 and September 27, 1989 transfers it received from Douglas into Bethany's account at Bank One, formerly known as the First National Bank of Clintonville, account no. 110314. Bethany deposited the September 1989 transfer of $1,000 into Bethany's account at First State Bank, account no. 804-009-8. (*Id.* ¶ 28) The monies transferred to Bethany were monies Douglas obtained from D & S, AT Systems and AT Service. (*Id.* ¶ 29) Given that all Douglas' income from August 1987

to November 1989 was derived from D & S, AT Systems and AT Service, the funds transferred to Bethany were monies originating from one or more of those entities. (*Id.*)

For the transfers it received from Douglas, Bethany purportedly provided "an express or implied promise that his donation would be used for the tax exempt purposes of [Bethany] and, more specifically, for the purpose or purposes for which he designated his donations." (*Id.* ¶ 30) Neither Douglas, D & S, AT Systems nor AT Service received any money or other assets from Bethany. (*Id.*) Douglas claimed at least the December 8, 1988, transfer as a deduction for a charitable contribution on his 1988 federal income tax return. (*Id.*)

***AFRICAN ENTERPRISE, INC.***

Douglas made the following charitable contributions to African Enterprise on the respectively indicated dates.

| Date | Dollar Amount |
|---|---|
| October 18, 1988 | 25,000.00 |
| November 29, 1988 | 1,000.00 |
| January 11, 1989 | 25,000.00 |
| June 6, 1989 | 75,000.00 |
| October 10, 1989 | 40,000.00 |
| Total: | $166,000.00 |

(Pl.'s African Enterprise 12(m) Stmt., ¶ 23) African Enterprise deposited the monies it received from Douglas into African Enterprise's account at Bank of America, account no. 02303-016151. (*Id.* ¶ 24) The monies transferred to African Enterprise were monies Douglas obtained from D & S, AT Systems and AT Service. (*Id.* ¶ 25) Given that all Douglas' income from August 1987 to November 1989 was derived from D & S, AT Systems and AT Service, the

funds transferred to African Enterprise were monies originating from one or more of those entities. (*Id.*)

For the transfers it received from Douglas, African Enterprise purportedly provided "an express or implied promise that his donation would be used for the tax exempt purposes of [African Enterprise] and, more specifically, for the purpose or purposes for which he designated his donations." (*Id.* ¶ 26) Neither Douglas, D & S, AT Systems nor AT Service received any money or other assets from African Enterprise. (*Id.*) Douglas claimed at least the October 18, 1988 and November 29, 1988 transfers as a deduction for charitable contributions on his 1988 federal income tax return. (*Id.*) African Enterprise issued Douglas a receipt for each donation noted above, acknowledging each transfer as a "tax deductible contribution to our ministry." (*Id.*)

## *II. DISCUSSION*[15]

### *A. Evidentiary Issues*

Defendants first argue that four exhibits plaintiff substantially relies upon are inadmissible. The defendants argue that Scholes'

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[15]Summary judgment will be granted if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." FED.R.CIV.P. 56(c). A party opposing a motion for summary judgment must set forth specific facts showing that there is a genuine issue for trial. *Celotex Corp. v. Catrett*, 477 U.S. 317, 324, 106 S.Ct. 2548, 2553, 91 L.Ed.2d 265 (1986); *Schroeder v. Lufthansa German Airlines*, 875 F.2d 613, 620 (7th Cir.1989). A genuine issue of material fact exists only where there is sufficient evidence favoring the non-moving party to support a jury verdict for that party. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248-50, 106 S.Ct. 2505, 2510-11, 91 L.Ed.2d 202 (1986). All reasonable factual inferences must be viewed in favor of the non-moving party. *Holland v. Jefferson Nat'l. Life Ins. Co.*, 883 F.2d 1307, 1312 (7th Cir.1989). If the evidence presented by the non-movant is merely colorable or is not sufficiently probative, summary judgment is appropriate. *Wolf v. Fitchburg*, 870 F.2d 1327, 1330 (7th Cir.1989).

affidavit and the affidavit of his retained accountant, Richard A. Mark, do not meet the requirements of Rule 56(e) or 28 U.S.C. § 1746. (Hindustan Mem. in Opp. to Pl.'s Mot. for Summ. J., at 2; see Affidavit of Steven S. Scholes attached as Exhibit B to Pl.'s Hindustan 12(m) Stmt., Affidavit of Richard A. Mark attached as Exhibit A to Pl.'s Hindustan 12(m) Stmt.) This argument is unpersuasive and is rejected. The Affidavits meet all requirements of Rule 56(e) and 28 U.S.C. § 1746.

Hindustan and International Students next argue that the deposition of Douglas is inadmissible because "unsigned, unauthenticated, and unverified" and noticed and taken in another proceeding. They argue the deposition transcript, therefore, fails to comply with Federal Rules of Civil Procedure 30 and 32. The Receiver retorts that the deposition is admissible because Douglas "waived any irregularities in the signing of the transcript under FED.R.CIV.P. 32(d)(4)." (AE Reply Mem., at 3 (citing Brown v. ASD Computing Center, 519 F.Supp. 1096, 1098 (S.D.Ohio 1981), and Kawietzke v. Rarich, 198 F.Supp. 841, 842-43 (E.D.Penn.1961))) Scholes further responds that the court reporter certified the deposition transcript in compliance with Rule 30(f)(1). (AE Reply Mem., at 3; Exhibit H attached thereto (copy of certification)) Lastly, Scholes asserts that the deposition testimony may be offered as an affidavit even if not admissible as deposition testimony under Rule 32. (AE Reply Mem., at 4 (citing *Peterson v. Instapak Corp.*, 690 F.Supp. 697, 700 n. 4 (N.D.Ill.1988), aff'd, 902 F.2d 1232 (7th Cir.1990); *Hoover v. Switlick Parachute Co.*, 663 F.2d 964 (9th Cir.1981); and *Microsoft Corp. v. Very Competitive Computer Products*, 671 F.Supp. 1250, 1254 n. 2 (N.D.Cal.1987))) We agree with plaintiff. Although Douglas' deposition may not be admissible at trial as evidence, it is accepted here as affidavit testimony. *See Peterson*, 690 F.Supp. at 700 n. 4.

Lastly, defendants object that the Indictment is inadmissible because it contains mere allegations. As such, defendants argue, the Indictment is conclusory, contains only hearsay and is of no probative value. Plaintiff responds by arguing only that defendants' argument is moot because plaintiff submitted a certified copy of the

indictment and because it should be read in conjunction with the criminal judgment. The court agrees with defendants. *See United States v. Garcia*, 562 F.2d 411, 417 (7th Cir.1977) (indictment is not evidence). The allegations made in the Indictment will not be relied upon by the court as evidence in regards to the summary judgment motions.

### *B. Fraudulent Conveyances*

To recover the conveyances Douglas made to the defendants, the Receiver asserts a claim of fraudulent conveyance against each defendant. Governing this cause of action is the Illinois fraudulent conveyance statute in effect at the time the transfers were made and since repealed:

> Every gift, grant [or] conveyance ... made with intent to disturb, delay, hinder or defraud creditors or other persons ... shall be void as against such creditors, purchasers and other persons.

ILL.REV.STAT. ch. 59, ¶ 4 (1989) (repealed by P.A. 86-814, § 13 effective January 1, 1990). "In order to establish that a conveyance is fraudulent in law, three elements must be present: (1) there must be a transfer made for no or inadequate consideration; (2) there must be existing or contemplated indebtedness against the transferor; and (3) it must appear that the transferor did not retain sufficient property to pay his indebtedness." *Gendron v. Chicago & North Western Transp. Co.*, 139 Ill.2d 422, 151 Ill.Dec. 545, 553, 564 N.E.2d 1207, 1215, (1990).[16] The parties do not dispute that Douglas conveyed funds to the defendants. The defendants challenge the Receiver's proof of every other element of this claim.

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[16]Illinois law distinguishes conveyances that are "fraudulent in law," from those that are "fraudulent in fact." Conveyances are "fraudulent in fact" where consideration exists for the transfer, but an actual intent to defraud exists on the part of the debtor, and the transferee willingly participates in the fraud. *Reagan v. Baird*, 140 Ill.App.3d 58, 65, 94 Ill.Dec. 151, 157, 487 N.E.2d 1028, 1034 (4th Dist.1985). Plaintiff in this case makes no claim for a conveyance "fraudulent in fact."

*1. Existing or Contemplated Indebtedness Against the Transferor*

Defendants forward three discernable arguments in support of their position that no indebtedness existed at the times of the conveyances. Defendants argue first that the Receiver cannot assert the prior judgments rendered against Douglas because the Receiver does not represent those creditors. Defendants next argue that the Receiver ignored Douglas' assets when determining Douglas' financial status. Lastly, defendants argue that the Receiver has not sufficiently identified investors or their claims. The first two arguments can be disposed of summarily. First, the Receiver need not represent Douglas' creditors in order to assert, as a factual matter, that the claims existed and, thus, that the transferor was indebted. This argument is rejected. Second, defendants' argument that the Receiver ignored Douglas' assets is without merit. The only citation in support of this argument is to a purported affidavit of Douglas which was stricken by this court. This assertion is, therefore, disregarded. Furthermore, defendants argue that the money Douglas misappropriated from the entities should be considered an asset of Douglas to offset any creditors' claims. (*See, e.g.*, Mem. of Certain Defs. in Supp. of Mot. for Summ. J., at 10-11 and n. 7) This is a *non sequitur*. Douglas' unlawful withdrawal of the funds from the entities gave rise to claims by the entities and investors against Douglas for those funds. To argue that once Douglas gained possession of the ill-gotten gains the funds became assets of Douglas is incongruous. Defendants have offered absolutely no evidence showing, or tending to show, that Douglas' receipt of the funds he took from the entities was in any way legitimate or could in any way be characterized as valid. This argument is therefore rejected.

As to the argument that the Receiver has not identified any creditors existing at the times of the conveyances, the Receiver replies that to establish the required indebtedness "a plaintiff need only establish a party with a subsisting claim against the debtor at the time of the conveyance ... even though his claim may not have matured or been reduced to judgment until after the conveyance was

made." (Pl.'s Mem. in Supp. of Mot. for Summ. J. against Heart Cry and World Vision, at 6 (citing *Indiana National Bank v. Gamble*, 612 F.Supp. 1272, 1277 (N.D.Ill.1984))) Plaintiff argues that the receivership entities had contemplated or existing indebtedness at the time of each conveyance because, due to Douglas' scheme to defraud, investors had breach of contract claims and fraud claims against Douglas and the entities from the inception of the scheme. (Pl.'s Mem. in Supp. of Mot. for Summ. J. against Hindustan defendants, at 7-8 (citing *Kennard v. Curran*, 239 Ill. 122, 87 N.E. 913, 916 (1909) ("all claims which arise from contract are in force from the date of the agreement"); and (*Menconi v. Davison*, 80 Ill.App.2d 1, 225 N.E.2d 139 (1st Dist.1967)) The court agrees with plaintiff. No genuine issue of material fact exists as to whether there existed an actual or contemplated indebtedness against the transferor at the times of the transfers.

Douglas conveyed more than half of a million dollars to these defendants. The money did not belong to Douglas. During the operation of the receivership entities, Douglas had no income other than the funds he took from the entities. (Douglas Dep., at pp. 56-58) The money originated with investors who attempted to invest the money with the receivership entities. Upon transferring their funds to Douglas and/or the entities, the investors entered into limited partnership agreements with Douglas and the entities. (*See* Pl.'s Heart Cry 12(m) Stmt., ¶ 15 and Exhibit K (copies of limited partnership agreements)) As either the general partner or as the person who controlled the general partner of the purported limited partnerships, Douglas owed the investor partners and the entities a fiduciary duty of good faith. *See Bane v. Ferguson*, 707 F.Supp. 988, 996 (N.D.Ill.) (under Illinois law, "all partners are fiduciaries for one another"), *aff'd*, 890 F.2d 11 (7th Cir.1989); *Fisher v. Samuels*, 691 F.Supp. 63, 73 (N.D.Ill.1988); *Labovitz v. Dolan*, 189 Ill.App.3d 403, 408, 136 Ill.Dec. 780, 784, 545 N.E.2d 304, 308 (1st Dist.1989). When Douglas withdrew the funds from the entities with the intent of expending the funds for his own purposes, he breached his duties to the entities. (Plea Agreement, ¶ 5) Thus, when the expenditure of the funds coincided with his intent to dissipate the funds in a manner

inconsistent with his fiduciary responsibilities, contemplated indebtedness arose in favor of the entities against Douglas. Thus, indebtedness arose against Douglas and the entities when Douglas misappropriated funds belonging to the entities and conveyed these funds to the defendants.

For the foregoing reasons, Scholes has shown, and the defendants have failed to rebut, that no genuine issue of material fact exists that actual and contemplated indebtedness against Douglas and the receivership entities existed at the times of the conveyances alleged.

***2. The Transferor Did Not Retain Sufficient Property to Pay the Indebtedness***

Scholes argues that to satisfy this element, he need only show that "the conveyance *tended to* ... impair the rights of creditors". (Pl.'s Mem. in Supp. of Mot. for Summ. J. against Hindustan defendants, at 9-10 (emphasis added) (citing *Tcherepnin v. Franz*, 457 F.Supp. 832, 840 (N.D.Ill.1978); *Birney v. Solomon*, 348 Ill. 410, 414, 181 N.E. 318, 320 (1932); *Cairo Lumber Co. v. Ladenberger*, 313 Ill.App. 1, 6, 39 N.E.2d 596, 599 (4th Dist.1941))) He further argues that the conveyances at issue not only tended to impair creditors' rights but did, in fact, injure creditors because Douglas was insolvent at all relevant times. Scholes asserts Douglas was insolvent "both in the sense that his liabilities exceeded his assets and in the sense that he was unable to pay his debts as they came due." (Pl.'s Mem. in Supp. of Mot. for Summ. J. against Hindustan defendants, at 10) In support, the Receiver proffers copies of judgments against Douglas showing over $28,000 of judgments existed against him when he initiated the fraudulent investment scheme. He also tenders Douglas' deposition in which Douglas testifies that he had no income during the existence of the scheme other than the funds that he misappropriated from the receivership entities. (Pl.'s Hindustan 12(m) Stmt., at ¶ 10) Scholes further proffers the affidavit of an accountant, Richard A. Mark, in which Mark testifies that Douglas was insolvent during all relevant times. (*Id.*, at ¶ 10 (citing Mark Dep. at ¶ 3)) Plaintiff argues this evidence demonstrates Douglas was

insolvent during the entire scheme and, thus, he was insolvent when he made the conveyances.

In response, defendants forward the same arguments they asserted in opposition to Scholes' averment that Douglas and the entities had existing or contemplated indebtedness. As stated above, these arguments fail. Defendants argue that the Receiver "disregards Douglas' *assets* (12(n) [Stmt.], ¶ A.9)". (Defendants Hindustan and International Students' Mem. in Opp., at 9) As stated above, this bald statement, without more, cannot create a genuine issue of material fact. Therefore, this argument cannot work to defeat summary judgment. Defendants cite no facts in support of their conclusory arguments that Douglas and the receivership entities retained sufficient assets to pay their creditors.

Defendants' only argument in opposition to this element which requires further discussion is that Mark, when concluding that Douglas and the entities were insolvent, made invalid assumptions. (*See, e.g.*, Hindustan Defs.' 12(n) Stmt., at 20-22) In his deposition testimony, Mark attested that he assumed, when conducting his solvency analysis, that Douglas and the entities "had an obligation to repay to the investors all of the funds that the investors had invested." (Mark Affidavit, at 63, attached as Exhibit 5 to Hindustan Defs.' 12(n) Stmt.) Mark further attested that, if these obligations did not exist, then D & S, AT Systems and AT Service would each in 1987, 1988 and 1989 "have been in a position in which assets exceeded liabilities". (*Id.*, at 67) Without discrediting the assumption itself, defendants argue solely that Mark's conclusions are invalid because based on mere assumption. (*See* Certain Defs.' Reply Brief in Supp. of Mot. for Summ. J., at 9-11) Defendants offer no evidence to contradict the assumption.

We agree with the assumption made by Mark and find that Douglas and the entities were insolvent at all relevant times. From January 1987, when Douglas was released from prison after serving a sentence for an unrelated fraud, until August 1987 when Douglas created D & S and began the purported investment scheme, Douglas

earned $10,060.48 legitimately. (Pl.'s Hindustan 12(m) Stmt. at ¶ 9; Douglas Dep., at pp. 53-55) At the time of his release from prison in 1987, judgments in the aggregate amount of at least $28,166.06 existed against him. (*Id.*, at ¶ 8) None of those judgments has been satisfied. *Id.* Furthermore, Douglas has admitted, and no party has controverted, that Douglas had no legitimate source of income from August 1987 through November 1989, when the scheme terminated and Scholes was appointed Receiver. (*Id.* at ¶ 10) Any assets possessed by Douglas from August 1987 to November 1989 were obtained wrongfully from the receivership entities. (*Id.*) Furthermore, the entities were created by Douglas solely to perpetrate fraud. (Plea Agreement, ¶ 5) As such, the investors did, indeed, have claims for their investments from the time they invested and executed the investment agreements. Additionally, although defendants imply that Douglas did consummate some legitimate investment transactions on behalf of the entities, they have wholly failed to substantiate such claims. Even if such transactions occurred, however, defendants no where contend that the transactions rendered Douglas or the entities solvent. As such, this element of plaintiff's fraudulent conveyance claims has been demonstrated as a matter of law.

*3. No or Inadequate Consideration*

The Receiver alleges that defendants gave no valuable consideration for the conveyances. Defendants assert that they gave consideration or its equivalent for the conveyances. The parties do not dispute that the defendants gave Douglas and the entities no valuable assets in exchange for the conveyances by Douglas. Defendants argue that the consideration they provided "consists of ... some forbearance, detriment, loss or responsibility given, suffered or undertaken by" them. (*See, e.g.*, Hindustan Defs.' Mem. in Opp. to Pl.'s Mem. in Supp., at 5 (citing *Lipkin v. Koren*, 392 Ill. 400, 406, 64 N.E.2d 890, 893 (1946))) According to defendants, they were required by law, as non-profit, tax-exempt organizations, to use the conveyed funds in accordance with their charters. (*See, e.g.*, Hindustan Defs.' Mem. in Opp. to Pl.'s Mot. for Summ. J., at 6

(referring to "state law and § 501(c)(3) of the Internal Revenue Code")) They argue that "each time [a defendant] accepted a contribution, it assumed the duty, responsibility or detriment of using that contribution not for its own benefit, but for the purpose for which that contribution was designated or, if the contribution was not designated, for the charitable purposes for which the organization existed". (*Id.*, at 7) This, they argue, constitutes consideration for the conveyances. Finally, defendants argue, even if their charitable legal requirements do not constitute consideration, the doctrine of promissory estoppel does because it is "usually considered as a substitute for consideration". (*Id.*, at 8 (citing *Bank of Marion v. Robert "Chick" Fritz, Inc.*, 57 Ill.2d 120, 124, 311 N.E.2d 138, 140 (1974))) Defendants' arguments fail.

First, mere compliance with the law does not constitute consideration. *See W.H. Lyman Constr. Co. v. Village of Gurnee*, 131 Ill.App.3d 87, 86 Ill.Dec. 276, 282, 475 N.E.2d 273, 279 (2d Dist.1985); *Adams v. Lockformer Co.*, 167 Ill.App.3d 93, 117 Ill.Dec. 826, 828-29, 520 N.E.2d 1177, 1179-80 (1st Dist.1988). Although as a general proposition defendants are correct that forbearance can constitute consideration in a contractual setting, that tenet does not extend to the performance of one's statutorily required duty nor does it extend to the circumstances of this case. Any forbearance undertaken or detriment incurred by a party must be bargained for, and arise as a result of the transaction, to constitute consideration. *Tcherepnin*, 457 F.Supp. at 837; *Bank of Marion*, 311 N.E.2d at 139-40. The forbearance or detriment asserted by each defendant was not something for which the defendants bargained and the defendants do not so argue. Indeed, as asserted by the defendants, the detriment each incurred was required by law of all charitable organizations. Therefore, the characterization defendants place on their donations--that the funds constituted a duty or responsibility on their parts--does not rise to the level of legally cognizable consideration.

Second, promissory estoppel does not act as a substitute for consideration in this case. Promissory estoppel applies where a

promise is made which induces reasonable reliance by the promisee. *Bank of Marion*, 311 N.E.2d at 140. In such case, promissory estoppel may be a substitute for consideration thus enabling the promisee to sue on the promise. *Id.* This is not such a case. In this case, defendants do not even assert a promise upon which they reasonably relied. The most defendants aver is that "Douglas, either explicitly ... or implicitly ... indicated that the contributions were to be used for specific purposes". (Mem. of Certain Defs. in Supp. of their Mot. for Summ. J., at 9) This "indication" cannot constitute consideration. Defendants' argument that their unspecified reliance on some uncited promise constitutes consideration in this action is rejected.

Furthermore, as the Receiver notes, only valuable consideration will negate a charge of fraudulent conveyance under the Illinois statute as interpreted by Illinois courts. *See, e.g., Tcherepnin v. Franz*, 475 F.Supp. 92, 97 (N.D.Ill.1979) (court compared the monetary value of the property conveyed to legal value of consideration received by grantor); *Gamble*, 612 F.Supp. at 1276 (same); *Thompson v. Williams*, 6 Ill.2d 208, 215, 127 N.E.2d 457, 461 (1955) (same); *Reagan v. Baird*, 140 Ill.App.3d 58, 94 Ill.Dec. 151, 157-58, 487 N.E.2d 1028, 1034-35 (4th Dist.1985) (same); *Effingham State Bank v. Blades*, 139 Ill.App.3d 259, 93 Ill.Dec. 764, 768, 487 N.E.2d 431, 435 (5th Dist.1985) (same); *Hormberger v. Blackwell*, 241 Ill.App. 398, 401 (4th Dist.1926) (same); *Oswald v. Nehls*, 233 Ill. 438, 84 N.E. 619, 622 (1908) (love and affection is not adequate consideration); *Cairo Lumber Co. v. Ladenberger*, 313 Ill.App. 1, 39 N.E.2d 596, 599 (4th Dist.1941) (same); *see also Zahra Spiritual Trust v. United States*, 910 F.2d 240, 248-49 (5th Cir.1990) (under similar Texas law, court focuses on monetary, not spiritual, consideration to decide if conveyance to a charitable trust was fraudulent). The purpose for this seems clear. Only consideration of substantially equivalent value leaves the debtor in a financially similar position after the conveyance. A conveyance made for consideration of nominal or no monetary value leaves the debtor in a much weakened financial position which hinders his creditors. *See United States v. Kitsos*, 770 F.Supp. 1230, 1235-36 n.

14 (N.D.Ill.1991) ("relevant determination is whether *full* value has been given"). This is precisely the scenario the statute attempts to prevent. Recognizing consideration of no monetary value as a defense to a fraudulent conveyance would emasculate the statute. The Receiver has shown that, as a matter of law, the defendants gave no consideration for the transfers at issue.

Lastly, defendants argue that plaintiff's claims for fraudulent conveyance must fail because the exclusive remedy is retrieval of the property transferred but that defendants no longer possess the actual funds. (Mem. of Certain Defs. in Supp. of Their Mot. for Summ. J., at 12-13) Thus, defendants argue, plaintiff's claims must fail. We disagree. *See Tcherepnin v. Franz*, 489 F.Supp. 43, 45 (N.D.Ill.1980) ("well-settled" that creditor may elect to recover property itself or its cash value). A personal judgment against the transferee is appropriate.

For all the foregoing reasons, the court grants the plaintiff's motions for summary judgment on his claims for fraudulent conveyances against defendants African Enterprise, Inc., Bethany Evangelical Free Church, Heart Cry International, Hindustan Bible Institute, Inc., International Students, Inc., Proclamation International, and World Vision, Inc. Defendants' motions for summary judgment on the Receiver's claims for fraudulent conveyance are denied.

### *C. Unjust Enrichment*

Also asserted by the Receiver against each defendant is a claim for unjust enrichment. Because the court has found that the Receiver is entitled to judgment on his fraudulent conveyance claims, however, we need not pass upon the claims for unjust enrichment. All parties' motions are denied as to the claims for unjust enrichment.

## *III. CONCLUSION*

For the reasons expressed, the Receiver's Motion for Summary Judgment Against Hindustan Bible Institute, Inc., International Students, Inc., and Proclamation International, Inc. and the Receiver's Motion for Summary Judgment Against African Enterprise, Inc. and Bethany Evangelical Free Church, and the Receiver's Motion for Summary Judgment Against Heart Cry International and World Vision, Inc. are granted. The Motion of Certain Defendants for Summary Judgment and the Motion for Summary Judgment of Proclamation International Inc. and Bethany Evangelical Free Church are denied. Judgment is entered on Counts I, IV, XIX, XXII, XXV, XXXVII and XLVI of the plaintiff's First Amended Complaint in favor of the Receiver Steven S. Scholes and against defendants African Enterprise, Inc., Bethany Evangelical Free Church, Heart Cry International, Hindustan Bible Institute, Inc., International Students, Inc., Proclamation International, Inc., and World Vision, Inc., in the following amounts.

| Defendant | Judgment Amount |
|---|---|
| African Enterprise, Inc. | $166,000.00 |
| Bethany Evangelical Free Church | $ 26,880.00 |
| Heart Cry International | $ 12,485.00 |
| Hindustan Bible Institute, Inc. | $ 74,989.25 |
| International Students, Inc. | $120,450.00 |
| Proclamation International, Inc. | $ 51,228.13 |
| World Vision, Inc. | $ 57,500.00 |

This court finds that there is no just reason for delay, and therefore the clerk is directed to enter final judgment against the defendants pursuant to **FED.R.CIV.P.** 54(b).

838 F.Supp. 349

Steven S. SCHOLES, not individually, but solely as Receiver for Michael S. Douglas, D & S Trading Group, Ltd., Analytic Trading Systems, Inc., Analytic Trading Service, Inc., and Market Systems, Inc., Plaintiff,

v.

AFRICAN ENTERPRISE, INC., Bethany Evangelical Free Church, Calvary Chapel of Chula Vista, Camp Elim and other Youth Ministries of Haiti, Food for the Hungry, Inc., Gospel Revival Ministries, Heart Cry International, Hindustan Bible Institute, Inc., International Students, Inc., Lake Forest Academy, Lakeland Evangelical Free Church, Operation Brotherhood West Center, Proclamation International, Trinity College, Trinity Evangelical Divinity School, World Vision Inc., and Camp Forest Springs, Defendants.

No. 90 C 3989.

United States District Court,
N.D. Illinois, E.D.

Nov. 16, 1993.

Wilber H. Boies, Gary L. Prior, Richard Lawton Sandler, Jane M. Simon, Michael V. Hughes, Mary B. Tribby, Mark Thomas Ostrowski, McDermott, Will & Emery, P.C., Ruta K. Stropus, Sachnoff & Weaver, Ltd., Chicago, IL, for plaintiffs.

Timothy C. Klenk, Jerome Kiley Bowman, Pope, Ballard, Shepard & Fowle, Ltd., Catherine Patricia Wassberg, Jenner & Block, Robert Ronald Tepper, Law Offices of Robert R. Tepper, Chicago, IL, Paul B. Newman, Newaygo, MI, Scott H. Kenig,

O'Neill & Bockelman, P.C., Lake Forest, IL, C. William Bockelman, Jr., O'Neill & Bockelman, P.C., Lake Forest, IL, James A. Davids, Bruce J. Van Heukelem, Hoogendoorn, Talbot, Davids, Godfrey & Milligan, Chicago, IL, H. Robert Showers, Peter Rathbun, Gannon & Grange, McLean, VA, for defendants.

***MEMORANDUM OPINION AND ORDER***

ALESIA, District Judge.

At issue in this case is whether an equity receiver for certain defunct entities has asserted cognizable claims on behalf of the entities to recover funds allegedly fraudulently transferred by a principal of the entities to the defendants. In his First Amended Complaint, plaintiff Steven S. Scholes, as Receiver ("the Receiver") for Michael S. Douglas, D & S Trading Group, Ltd. ("D & S"), Analytic Trading Systems, Inc. ("AT Systems"), Analytic Trading Service, Inc. ("AT Service"), and Market Systems, Inc. ("MSI"), collectively referred to as the receivership entities, asserts 51 Counts. He asserts a fraudulent conveyance count, an unjust enrichment count and a constructive trust count against each of the 17 Charity defendants. Presently before the court are the parties' Objections, and corresponding Responses, to the recommendation of Magistrate Judge Pallmeyer to grant in part and deny in part the Motion to Dismiss brought by defendants African Enterprise, Inc., Bethany Evangelical Free Church, Food for the Hungry, Inc., Hindustan Bible Institute, International Students, Inc., Proclamation International, Inc., Trinity College, Trinity Evangelical Divinity School, World Vision, Inc., Lake Forest Academy, Heart Cry International, and Camp Elim and Other Youth Ministries of Haiti.[17] Collectively, these

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[17]The court recently granted the Receiver's Application for Approval of Settlement Agreement with Trinity Evangelical Divinity School and Food for the Hungry, Inc. Therefore, this Motion to Dismiss is moot as to those two defendants.

defendants are referred to as the Charities or generally as the defendants.

## *I. FACTS*[18]

On November 13, 1989, the Securities and Exchange Commission ("SEC") filed an action in this District Court against Douglas and three of the receivership entities (D & S, AT Systems and AT Service), alleging numerous violations of federal securities laws. Complaint, ¶ 2. On November 30, 1989, this court appointed Steven S. Scholes as equitable receiver for defendants in the SEC action and directed Scholes to take possession of and liquidate all their choses in action and to recover their assets. *Id.* The Receiver purports to bring this action pursuant to his obligations under the November, 1989 order and a subsequent order in which the court placed MSI in receivership and appointed Scholes as its receiver, as well. *Id.* ¶ 3. The Receiver asserts that jurisdiction over this action is ancillary to the court's jurisdiction over the SEC action. *Id.* ¶ 4.

Beginning in 1987, Douglas created an investment partnership, D & S, of which he was a general partner. *Id.* ¶ 6. Douglas and others diverted and misappropriated funds belonging to D & S for their own use. *Id.* ¶ 7. In 1988, Douglas and others created another investment partnership (which was never named), of which AT Systems was the general partner. AT Systems had been created as a mechanism into which D & S funds could be funnelled without notice to state securities regulators, and then looted. *Id.* ¶ 9. In 1989, Douglas and others created AT Service, which was intended to be the managing general partner of a partnership into which both D & S and AT Systems funds could be funnelled, again without drawing the attention of regulators. Douglas managed the affairs of AT Service through MSI, a wholly owned corporation funded with assets

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[18]The facts set out below are from the First Amended Complaint and set out in the R & R and are deemed true for purposes of the motion to dismiss. *See* R & R, at pp. 3-5; *Conley v. Gibson*, 355 U.S. 41, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957).

belonging to the defendants in the SEC action. *Id.* ¶ 10. Douglas and others formed both AT Service and MSI "in order to loot them." *Id.*

The Complaint asserts fifty-one counts, three counts against each of the seventeen defendant Charities. The Receiver alleges that each of the Charities received assets diverted from one or more of the receivership entities. With respect to all but three of the Charities, it is alleged that the diverted assets were in the form of checks drawn on Douglas' personal bank accounts. (The source of the allegedly diverted assets now in the hands of the remaining defendant Charities is not stated.) The Receiver alleges that the Charities' receipt of the allegedly diverted assets constitutes a fraudulent conveyance (Counts I, IV, VII, X, XIII, etc.); violates fundamental principles of justice, equity and good conscience, and therefore constitutes unjust enrichment (Counts II, V, VIII, XI, etc.); and requires imposition by this court of a constructive trust on the improperly obtained assets (Counts III, VI, IX, XII, etc.).

## II. BACKGROUND

In their Motion to Dismiss, defendants argue that this suit should be dismissed because (1) the Receiver lacks standing to assert the fraudulent conveyance claims, (2) the court lacks personal jurisdiction over six of the Charities, (3) the Complaint fails to state a claim for fraudulent conveyance under the Illinois statute, (4) the Complaint fails to state a claim for imposition of a constructive trust and (5) the Complaint fails to state a claim for unjust enrichment. The issues of personal jurisdiction were subsequently separated from the other arguments and will be addressed separately. In her January 5, 1993 Report and Recommendation ("R & R") on the motion, Magistrate Judge Pallmeyer recommended granting defendants' motion as to the unjust enrichment claims and constructive trust claims, and recommended denying the motion as to the fraudulent conveyance claims. *Scholes v. African Enterprise, Inc.*, No. 90 C 3989 (N.D.Ill. January 5, 1993) (Report and Recommendation of Magistrate Judge Pallmeyer). Both sides submitted Objections to the R & R and Responses to the others' Objections. Pursuant to 28

U.S.C. § 636(b), this count will review de novo those portions of the R & R to which objections are made.

## *III. DISCUSSION*

### *A. Fraudulent Conveyance Claims*

#### *1. Standing*

In their motion, defendants argued first that the Receiver lacks standing to raise the fraudulent conveyance claims. Defendants argued that the Receiver lacks standing because (1) the Illinois fraudulent conveyance statute in effect at the time allows only creditors to raise such a claim and the Receiver is not a creditor, (2) the order appointing Scholes receiver does not allow him to raise such a claim, and (3) by law, a Receiver cannot assert such claims which belong to third parties and not to the receivership entities. The Magistrate Judge concluded that the Receiver has standing and creditor status to raise fraudulent conveyance claims under the Illinois law. R & R, at p. 23. The defendants object to this conclusion by arguing that the Magistrate Judge improperly relied on bankruptcy decisions and that she failed to give proper credence to prior orders of this court. This court will address first the issue of whether the Receiver can raise claims of third parties.

In the R & R, the Magistrate Judge extensively and thoroughly analyzes analogous case law and determines that the Receiver has standing to raise fraudulent conveyance claims that benefit the general creditors of the receivership entities. R & R, at pp. 9, 15, 23. In their objections to this conclusion, the defendants argue that the case law is clear that equity receivers have no standing to raise claims of third parties. Defs.' Objections, at pp. 6-12. In response, the Receiver argues that the case law does not preclude a receiver from asserting fraudulent conveyance claims. Pl.'s Resp. to Defs.' Objections ("Pl.'s Resp."), at pp. 2-11. All the parties and the R & R initially focus on the Supreme Court's holding in *Caplin v. Marine*

*Midland Grace Trust Co.*, 406 U.S. 416, 92 S.Ct. 1678, 32 L.Ed.2d 195 (1972). *Caplin* is, thus, a good starting point.

Defendants argue that *Caplin* denies a trustee, appointed under the old Bankruptcy Act, standing to assert claims of third parties. Defendants further argue that an equity receiver, like Scholes, possesses authority comparable to and no greater than a trustee under the old Bankruptcy Act. Defs.' Objections, at p. 6. The Receiver counters that the defendants misread *Caplin* because in *Caplin* the trustee plaintiff conceded he was raising the claims of third- party debenture holders and not claims belonging to the entities in receivership. Pl.'s Resp., at p. 4. The Magistrate Judge essentially agreed with the Receiver and held that pre-*Caplin* cases which apply to the facts of this case allow the Receiver to raise such claims and that *Caplin* did not alter this conclusion. R & R, at pp. 6-9. This court agrees with the Magistrate Judge's view of *Caplin* but feels that a discussion of the *Caplin* line of cases at this point is premature.

Defendants argue that the Receiver lacks standing to raise the fraudulent conveyance claims because an equity receiver cannot raise claims of third parties. Defendants never discuss, however, *why* these claims belong to third parties and not to the receivership entities. The Receiver similarly fails to offer any analysis as to *who* was more directly injured as a result of Douglas' fraudulent conveyances--the entities themselves, or the investors. It seems to the court that this determination will significantly clear up the morass of the standing issue.

"At the core of the standing doctrine is the requirement that a plaintiff 'allege personal injury fairly traceable to the defendant's allegedly unlawful conduct and likely to be redressed by the requested relief' [citations omitted]." *County of Riverside v. McLaughlin*, 500 U.S. 44, ----, 111 S.Ct. 1661, 1667, 114 L.Ed.2d 49 (1991). Thus, the issue is who has sustained sufficient *personal* injury--the entities or the investors. The briefs of the parties lack any citation to authority on the injury requirements of standing. *See County of Riverside*, 500 U.S. at ----, 111 S.Ct. at 1667 (personal

injury at "core" of standing doctrine); *Allen v. Wright*, 468 U.S. 737, 751, 104 S.Ct. 3315, 3324, 82 L.Ed.2d 556 (1984) (personal injury a "core component" of standing); *Valley Forge Christian College v. Americans United for Separation of Church and State, Inc.*, 454 U.S. 464, 472, 102 S.Ct. 752, 758, 70 L.Ed.2d 700 (1982) (at a "minimum", plaintiff must "show that he personally suffered some ... injury"). These cases emphasize that standing necessarily involves a determination of redressable, cognizable injury to the plaintiff. Here, an analysis of who actually sustained the most direct injury, based on the allegations in the Complaint, demonstrates that the receivership entities have sustained the most direct, personal injuries as a result of Douglas' fraud and that the investors sustained only derivative injuries.

The Receiver has alleged direct, palpable injury to the receivership entities caused by Michael Douglas' actions. Once invested with the entities, the investor funds became partnership property. *See* 805 ILCS 205/8 (1992) (formerly ILL.REV.STAT. ch. 106 1/2 , ¶ 8 (1991)) ("All property ... acquired ... on account of the partnership is partnership property."); *see also Scheske v. Wiechert*, 119 N.E.2d 508, 510, 2 Ill.App.2d 331 (4th Dist.1954) ("the stock in trade is owned by the partnership as an entity and not by the individual partners"). Defendants here cite no evidence in opposition to this fundamental concept. In fact, in a case involving a Ponzi scheme and facts similar to this case, the Seventh Circuit held that "[i]f looting occurred, then [the looted entity] was injured, and [the entity's] receiver may chase [the recipient] to regain some of the misappropriated funds". *Southmark Corp. v. Cagan*, 999 F.2d 216, 223 (7th Cir.1993) (citing *Schacht v. Brown*, 711 F.2d 1343, 1348 (7th Cir.1983)); see also *Commodity Futures Trading Commission v. Tobin*, No. 89 C 8576, *Comm.Fut.Law R.* (CCH) at ¶ 25, 725-26, 1993 WL 157513 (N.D.Ill. May 10, 1993) (recognizing that a receiver can sue to recover transfers that harm the entity). Thus, the Charities have failed to show that the Receiver is unable to prove that when Michael Douglas misappropriated and transferred the invested funds, the partnership entities were thereby directly injured.

Therefore, because the entities *qua* entities suffered direct injury from the alleged fraudulent activities of Douglas and the defendants, the Receiver possesses the authority to assert causes of action on behalf of the general, managing partners of the entities to redress such wrongs. Whether or not the Illinois fraudulent conveyance statute, which allows "such creditors, purchasers and other persons" to bring such claims, recognizes the Receiver as a proper plaintiff is another matter. See ILL.REV.STAT. ch. 59, ¶ 4 (1987) (repealed by P.A. 86-814, § 13, effective January 1, 1990).

The Magistrate Judge recognized that the Illinois statute limits standing to creditors or "such other persons" and concluded that the Receiver is a proper plaintiff under the Illinois statute. R & R, at pp. 15-22. Defendants object on pragmatic grounds but cite no authority for their interpretation of the Illinois statute. The Receiver, in his Response, similarly does not rely on the relevant Illinois statute. The court agrees with the conclusion of the Magistrate Judge.

The relevant portion of the Illinois fraudulent conveyance statute in effect at the time of the conveyances alleged here states: "Every gift [or] conveyance ... made with intent to ... defraud creditors or other persons ... shall be void as against such creditors, purchasers and other persons." ILL.REV.STAT. ch. 59, ¶ 4 (1987). The broad language of this provision alone seems to allow the Receiver to raise the claim. Very little doubt arises that conveyances were made and that these conveyances were made to defraud creditors or other persons. All parties agree that a gift or conveyance was made to each defendant. Furthermore, each conveyance was made by Michael Douglas with the intent to defraud the investors and the entities themselves as evidenced by the fact that Michael Douglas pleaded guilty to fraud charges and is currently incarcerated. This clearly meets the requirements of "intent to defraud creditors or other persons". The final requirement of the Illinois statute is whether or not the conveyances are "void as against" the Receiver. The answer to this question is less clear.

As the Magistrate Judge noted, the case law indicates that, in general, "only creditors who had existing claims at the time of the conveyance may bring a fraudulent conveyance claim." R & R, at p. 16 (citing *Mandolini Co. v. Chicago Produce Suppliers, Inc.*, 184 Ill.App.3d 578, 581, 132 Ill.Dec. 765, 767-68, 540 N.E.2d 505, 507-08 (1st Dist.1989); *In re Martin*, 113 B.R. 949, 959 (Bankr.N.D.Ill.1990), *vacated*, 124 B.R. 69 (N.D.Ill.1991)). In *Mandolini*, creditors of an insolvent entity, CPS, sued a CPS-affiliated entity, S & M Produce, to recover funds transferred from S & M to CPS. In reversing the lower court's holding in favor of the plaintiff creditor, the court held that the "general law in Illinois is that only those creditors who had existing claims at the time of the transfer may complain that the transfer of property was made in derogation of their rights". *Mandolini*, 540 N.E.2d at 507. Defendants here rely on this proposition and argue that the Receiver was not and is not a creditor of the entities.

*Mandolini*, however, is distinguishable from the case at bar for two reasons. First, in support of its holding, *Mandolini* relied on *Chicago Daily News Co. v. Siegel*, 212 Ill. 617, 629-30, 72 N.E. 810 (1904) which, in turn, reasoned that "[i]f the conveyance was made before the indebtedness was incurred, then there was no fraud, as there was no design to hinder or delay creditors at the time". *Mandolini*, 540 N.E.2d at 507. Here, there clearly was a "design" to perpetrate fraud from the beginning. Thus, the purpose of requiring a concomitant debt is inapposite to these facts. Second, *Mandolini* expressly recognizes this concept. As declared by the court, "[a]n exception to the general rule provides that a voluntary conveyance may be set aside at the instance of subsequent creditors upon proof of actual fraudulent intent." *Mandolini*, 540 N.E.2d at 509 (citing 20 *ILP Fraudulent Conveyances* § 204; *Cramer v. Bode*, 24 Ill.App. 219 (1887); *National City Bank v. Cowdin*, 343 Ill. 430, 175 N.E. 411 (1931)). The Complaint here sufficiently alleges Douglas' actual fraudulent intent. The Receiver, therefore, need not be a concomitant creditor to raise the fraudulent conveyance claims. Thus, defendants' objections to this effect are overruled.

As the Magistrate Judge noted, however, "[n]either party has cited controlling authority interpreting the fraudulent conveyance statute in an action by a court-appointed receiver against the recipient of a conveyance from the very entity for which the receiver acts." R & R, at p. 17. Based on the wording of the fraudulent conveyance statute and analogous case law, however, this court finds that the Receiver is the proper, and perhaps exclusive, plaintiff to seek redress for the alleged facts based on the unique circumstances of this case. First, the words of the statute make clear that the set of appropriate persons, against whom fraudulent conveyances are void, is open-ended. Section 4 provides that such conveyances are void as against "creditors, purchasers and *other persons*". ILL.REV.STAT. ch. 59, ¶ 4 (1987) (emphasis added). Use of the phrase "and other persons" in the statutory provision indicates that persons other than creditors can bring such claims. Given the equitable nature of a suit to set aside fraudulent conveyances in the hands of third parties, *see Tcherepnin v. Franz*, 489 F.Supp. 43, 45 (N.D.Ill.1980), the court finds that the equities weigh in favor of interpreting the terms "such persons" in the Illinois statute to allow the Receiver in this case to assert violations of the fraudulent conveyance statute.

Secondly, analogous Illinois case law cited by the Magistrate Judge favors this interpretation of the Illinois statute in this case. First, in *Republic Life Ins. Co. v. Swigert*, 135 Ill. 150, 25 N.E. 680 (1890), a case upon which defendants rely, the Illinois Supreme Court refused to allow an insurance company receiver to assert fraudulent conveyance claims against the stockholders of the insurance company. In *Swigert*, the insurance company directors resolved to allow all stock subscribers to cancel their subscription contracts and thereby reduce their stock holdings to the number of shares represented by the amount each had already paid on the original stock subscription. In response, "a large number of the subscribers to the stock of said company surrendered their certificates of stock upon which but 20 per cent had been paid, and received in lieu thereof certificates for one- fifth the number of shares of stock so surrendered." *Swigert*, 25 N.E. at 681. According to the receiver in that case, the board resolution reduced the assets of

the corporation, thus hindering its ability to pay creditors. He therefore asserted claims against the stockholders to recover the funds they would have otherwise owed the company. The Illinois Supreme Court refused to allow him to assert the claims because they "belong[ed] to the creditors only". *Swigert*, 25 N.E. at 684. The claims belonged exclusively to the creditors, according to the court, because the action by the company's board of directors was an otherwise legitimate corporate action. As such, the corporation itself could not assert the claim. Thus, "the only liability [was] to the creditors", which the receiver could not assert. *Swigert*, 25 N.E. at 684-85. *Swigert* thus, reinforced the idea that receivers cannot raise claims of third parties. The facts of the case at bar, however, and the Illinois Supreme Court's subsequent decision in *Peabody v. New England Waterworks Co.*, 184 Ill. 625, 56 N.E. 957 (1900), make *Swigert* inapposite to this case.

Here, as opposed to the facts of *Swigert*, Douglas' actions were not legitimate partnership undertakings. Douglas' actions defrauded not just creditors but also the entities in receivership, for which he was supposed to be acting in a fiduciary capacity. When Douglas misappropriated funds belonging to the receivership entities, he defrauded and directly injured the entities. *See supra.* As such, each entity could sue in its own name to recover those monies. Thus, *Swigert* does not control and the Receiver can sue on behalf of the entities.

Furthermore, in *Peabody*, the Illinois Supreme Court retreated somewhat from *Swigert*. *Peabody* quoted the *Swigert* holding and then noted that "but, [where a receiver's] powers are derived from a statute, *or from a lawful decree of court* ... he is not circumscribed and limited by the right which was vested in and available" to the entity. *Peabody*, 56 N.E. at 958-59 (emphasis added). In *Peabody*, the receiver was appointed under a statute regarding corporations and the statute did not expressly or impliedly grant the receiver any authority to assert claims of third parties. Nevertheless, the court allowed the receiver to "defend not only the corporation but protect its creditors and stockholders from collusive and fraudulent

judgments". *Peabody*, 56 N.E. at 960. In this case, Scholes is acting under authority of a decree of this court allowing him to assert claims to recover assets of the receivership entities. Although there is no Illinois case law expressly allowing a receiver in such a situation to bring a fraudulent conveyance claim under the fraudulent conveyance statute, see R & R, at p. 17, there is also no case law to the contrary, and this court finds that a receiver in such a situation is a proper party to raise the claim. *See Federal Reserve Bank v. Omaha Nat'l Bank*, 45 F.2d 511, 518 (8th Cir.1930) ("the receiver of an insolvent bank is ordinarily the party to bring suit for the purpose of having [fraudulent] transfers adjudged null and void.").

Neither *Caplin* nor the pre-*Caplin* line of cases, on which the Magistrate Judge relies, affects this outcome. First, as stated, *Caplin* dealt with a trustee under the old Bankruptcy Act, 52 Stat. 83, asserting claims "on behalf of persons holding debentures" in the bankrupt entity. *Caplin*, 406 U.S. at 416, 92 S.Ct. at 1679. There was never any assertion that the trustee was suing on behalf of the bankrupt entity, as there is here. This court, in fact, continues to adhere to the holding in *Caplin*, as it must, that receivers may not assert claims of third parties. Furthermore, as the Magistrate Judge found, pre-*Caplin* cases support receiver standing in the present situation. See R & R, at pp. 7-9 (discussing *McCandless v. Furlaud*, 296 U.S. 140, 56 S.Ct. 41, 80 L.Ed. 121 (1935) (recognizing the receiver's authority to recover fraudulent conveyances because the receiver held the assets of the corporation "as a trust" and he had authority to bring the funds "back into the trust"); *Moore v. Bay*, 284 U.S. 4, 52 S.Ct. 3, 76 L.Ed. 133 (1931) (finding a trustee's authority to set aside a fraudulent conveyance broader than an individual creditor's)). Thus, defendants' objections that the cases relied upon by the Magistrate Judge are not relevant to the facts here are overruled.

Therefore, for the foregoing reasons, the court holds that Scholes, as the Receiver for D & S, AT Systems and AT Service, possesses standing and is the proper party to raise the fraudulent conveyance claims against these defendants.

*2. Failure to State Fraudulent Conveyance Claims*

As to the adequacy of the pleadings, the Magistrate Judge found that "[t]he Receiver has adequately pleaded that the transfers to Defendant Charities were fraudulent in law." R & R, at p. 26. Defendants object, saying the Receiver "never identifies any pre-existing creditors or the amounts of their claims," that the Receiver "lumps together the debts of Douglas and the other entities," and that consideration supported the transfers. Defs.' Objections, at p. 13. These objections are overruled.

First, a claim of fraudulent conveyance does not always require the existence of a pre-existing creditor. As stated *supra*, "an exception to the general rule provides that a voluntary conveyance may be set aside at the instance of subsequent creditors upon proof of actual fraudulent intent." *Mandolini*, 540 N.E.2d at 509. As Scholes alleges, and the court takes as true, "Douglas and others embarked upon a scheme to create an investment partnership ... and then to misappropriate its assets." First Amended Complaint, at p. 4 ¶ 6. The allegations of Douglas' mental state to actually defraud investors and the entities are sufficient. Furthermore, a "contemplated indebtedness" is sufficient and Scholes' allegations suffice to show that the entities and the investors could be shown to be contemplated claimants. *See Indiana Nat'l Bank v. Gamble*, 612 F.Supp. 1272, 1276 (N.D.Ill.1984). Thus, defendants' objection that Scholes failed to allege the existence of a pre-existing creditor is overruled.

Defendants' objection that the Receiver impermissibly lumps together the debts of Douglas and other entities is similarly overruled. In support of this objection, defendants cite a Report and Recommendation of Magistrate Judge Weisberg in *Scholes v. Moore*, No. 90 C 6615, at pp. 23-24 (N.D.Ill. June 28, 1991) (Mag. J. Weisberg). This, however, is not dispositive. A motion to dismiss will not be granted unless the movant can show that under no set of facts could plaintiff prove the claim. *Conley v. Gibson*, 355 U.S. 41, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957). Defendants cannot meet this

burden by arguing that Scholes lumps together the debts of Douglas. It is sufficient under the notice pleading requirements of the Federal Rules of Civil Procedure that plaintiff alleges that Douglas fraudulently transferred and misappropriated funds, in general, to defendants and others and that these transfers caused the receivership entities to become insolvent. Plaintiff's fraudulent conveyance claims will not be dismissed on this ground. This objection is overruled.

Next, the Charities object that "consideration ... support[s] Douglas' transfers to the charities" but that "a conveyance of the sort alleged here is only actionable if there was no consideration". Defs.' Objections, at p. 13. This objection is also overruled. First, the Receiver alleges in each fraudulent conveyance claim that the conveyances were made "without valid consideration". First Amended Complaint, at PP 17, 38, 55, 71, 88, etc. This is sufficient to withstand a motion to dismiss. Furthermore, defendants' objection that all conveyances to charitable organizations are necessarily made with valid consideration is overruled. Factual questions prevent the court from deciding this issue on this motion to dismiss. *See* R & R, at pp. 25-26 and cases cited therein. Whether or not valuable consideration was given for the transfers at issue in this case is more properly addressed in a motion for summary judgment or at trial. This objection is overruled. Therefore, the recommendation of the Magistrate Judge is accepted. Defendants' Motion to Dismiss plaintiff's fraudulent conveyance claims is denied.

***B. Constructive Trust and Unjust Enrichment Claims***

In the R & R, Magistrate Judge Pallmeyer concluded that the Receiver's constructive trust claims should be dismissed because constructive trust is a remedy and not a cause of action. She also recommended dismissing the unjust enrichment claims because constructive trust is the exclusive remedy for unjust enrichment which requires some wrongdoing and the Receiver did not allege any wrongdoing on the part of the Charities. R & R, at pp. 27-30. The Receiver objects to each of these recommendations, saying Illinois recognizes the cause of action of constructive trust and that

wrongdoing on the part of the Charities is not a requirement of an unjust enrichment claim. Defendants respond by arguing that constructive trust is not a cause of action and that wrongdoing on the part of defendants is necessary for the unjust enrichment claims.

First, the court overrules the objections of the Receiver regarding the constructive trust claims. Imposition of a constructive trust is a remedy and not a cause of action. *See* R & R, at pp. 27-30 and cases cited therein. As such, the claims of constructive trust are dismissed. A constructive trust may be an appropriate remedy in this case but may not be asserted as a separate cause of action.

Next, the Receiver objects that an unjust enrichment claim does not require allegations of wrongdoing by the defendants because a constructive trust is not the sole remedy for unjust enrichment, and that he has adequately alleged a cause of action for unjust enrichment. The Receiver's objection is sustained. In support of the assertion that the sole remedy for unjust enrichment is imposition of a constructive trust, the Magistrate Judge cited *Steinberg v. Chicago Medical Sch.*, 69 Ill.2d 320, 328, 13 Ill.Dec. 699, 703, 371 N.E.2d 634, 638 (1977). The R & R states "[a]s the Illinois Supreme Court has stated, a constructive trust is imposed 'to redress unjust enrichment where there is either actual fraud or implied fraud resulting from a fiduciary relationship'." R & R, at p. 29 (quoting *Steinberg*, 13 Ill.Dec. at 703, 371 N.E.2d at 638). The R & R goes on to cite a Seventh Circuit case for the proposition that "a constructive trust 'will not be imposed unless the complaint makes specific allegations of wrongdoing, such as fraud, breach of fiduciary duty, duress, coercion or mistake'." R & R, at p. 29 (quoting *Amendola v. Bayer*, 907 F.2d 760, 763 (7th Cir.1990)). Based on these quotations, the Magistrate Judge concluded that constructive trust is the exclusive remedy for unjust enrichment and that wrongdoing on the part of the defendant is therefore required for a claim of unjust enrichment. R & R, at p. 29. This court disagrees with the Magistrate Judge's conclusion based on these two cases.

*Steinberg* does not stand for the proposition that imposition of a constructive trust is the exclusive remedy of an unjust enrichment claim. In *Steinberg*, the plaintiff applied for admittance to the defendant medical school. The defendant rejected him. The plaintiff asserted four causes of action, one of which charged fraud, another of which charged unjust enrichment. The Illinois Supreme Court upheld the dismissal of both claims. In so doing, it held that "a construct trust may be imposed to redress unjust enrichment where there is either actual fraud or implied fraud ...". *Steinberg*, 13 Ill.Dec. at 703, 371 N.E.2d at 638 (emphasis added). Contrary to the deduction reached in the R & R, this language does not imply that constructive trust is the exclusive remedy for unjust enrichment. Therefore, the ultimate conclusion that the unjust enrichment claims require allegations necessary for imposition of a constructive trust is misplaced.

Furthermore, this court believes that unjust enrichment can be pleaded as a separate cause of action in Illinois. In *HPI Health Care Services, Inc. v. Mt. Vernon Hospital, Inc.*, 131 Ill.2d 145, 137 Ill.Dec. 19, 545 N.E.2d 672 (1989), the Illinois Supreme Court implicitly held that unjust enrichment exists as an independent cause of action. In *HPI*, the court noted that

> [t]he doctrine of unjust enrichment underlies a number of legal and equitable actions and remedies, including the equitable remedy of constructive trust and the legal actions of assumpsit and restitution or quasi-contract. [citation omitted]. To state a cause of action based on a theory of unjust enrichment, a plaintiff must allege that the defendant has unjustly retained a benefit to the plaintiff's detriment, and that defendant's retention of the benefit violates the fundamental principles of justice, equity, and good conscience.

*HPI*, 137 Ill.Dec. at 25-26, 545 N.E.2d at 678-79. Thus, the Illinois Supreme Court recognized unjust enrichment as an independent claim. No cases cited by the defendants point persuasively to the

contrary. Therefore, plaintiff's objection is sustained. The Receiver's claims for unjust enrichment will not be dismissed.[22]

## *IV. CONCLUSION*

For all the foregoing reasons, plaintiff's objections are sustained in part and overruled in part and defendants' objections are sustained in part and overruled in part. The defendants' Motion to Dismiss is granted to the extent that the claims of constructive trust are dismissed and only to the extent these claims are presented as distinct, independent causes of action. This conclusion does not prejudice the Receiver's right to seek a remedy of imposition of a constructive trust. The defendants' Motion to Dismiss is denied in all other respects.

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[22]By not dismissing plaintiff's unjust enrichment claims, the court does not mean to imply that the facts of this case necessarily fit into the class of cases to which the theory of unjust enrichment was intended to apply. Whether or not the defendants have retained a "benefit" to which unjust enrichment applies will be addressed on a motion for summary judgment in light of the facts presented.